CLERK'S COPY.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1944

No. 81

OTIS & CO., PETITIONER,

vs.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED MAY 11, 1944.

CERTIORARI GRANTED JUNE 12, 1944.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 81

OTIS & CO., PETITIONER,

vs.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX.

	Original	Print
Proceedings in U. S. C. C. A., Third Circuit	1	1
Appendix to brief for appellant	1	1
Relevant docket entries, United States District Court	1	1
Findings and opinion of the Securities and Exchange Commission	3	2
Dissenting opinion, Healy, Commissioner	46	37
Supplemental findings and opinion	87	77
Order granting application No. 14 as amended	89	78
Opinion of the United States District Court for the District of Delaware, Leahy, J.	94	82
Decree of the District Court	109	95
Amendment No. 1 to Application No. 14	112	98
Appendix to brief for Securities and Exchange Commission	121	104
Exhibit "A"—Pro forma corporate chart of Power and all subsidiaries thereof showing the percentage of each class of voting securities of each subsidiary held by Power and each subsidiary company thereof	122	104
Findings and opinion of Securities and Exchange Commission of March 20, 1941	123	105
Order of Securities and Exchange Commission of March 20, 1941	139	120

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., AUGUST 1, 1944.

—5195

	Original	Print
Appendix to brief for United Light and Power Co.	141	121
Notice to stockholders	141	121
Minute entry of argument and submission	143	123
Opinion, Biggs, J.	144	123
Judgment	164	142
Order amending opinion	165	142
Clerk's certificate (omitted in printing)	167	
Order granting certiorari	168	142

[fol. 1]

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Appendix to Brief for Appellant

In United States District Court, District of Delaware

Relevant Docket Entries

Apr. 16, 1943. Complaint filed.

Apr. 16, 1943. Order of Court setting this cause down for hearing June 15, 1943, at 10:00 A. M., and ordering United Light and Power Co. to give notice to certain stockholders, filed.

June 12, 1943. Proposed answer of Otis & Company; same day motion to file proposed answer with affidavit attached, filed.

June 15, 1943. Hearing on S. E. C. plan under Sec. 11(b).

July 30, 1943. Opinion re intervention of Otis & Co. and approval of plan, filed.

Aug. 4, 1943. Order permitting Otis & Co. to file objections and be heard nunc pro tunc, filed.

Aug. 4, 1943. Order confirming plan as fair and equitable, etc., filed.

Aug. 25, 1943. Notice of Appeal by Arthur G. Logan for Otis & Co., filed (copies sent to 3rd C. C. A., Roger S. Foster of S. E. C. and Clarence A. Southerland for United Light & Power), filed.

Aug. 25, 1943. Appeal Bond of Otis & Co., with Fidelity & Deposit Co., as surety in amount of $250.00, filed.

Sept. 22, 1943. Statement of Point on which Appellant intends to rely on appeal, filed.

Sept. 22, 1943. Designation of Contents of Record on Appeal, filed by Appellant.

[fol. 2] Oct. 2, 1943. Designation of Contents of Record on Appeal by Appellee, filed.

Oct. 2, 1943. Stipulation and order re original exhibits re record on appeal, filed.

Oct. 4, 1943. Motion of Appellant; same day order extending time for filing record on appeal until Oct. 14, 1943.

Oct. 4, 1943. Order correcting opinion of July 29, 1943, filed.

[fol. 3] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

FINDINGS AND OPINION—April 1, 1943

Simplification of Holding Company System

Plan Under Section 11 (e) "Necessary to Effectuate Provisions of 'Section 11 (b)' "

Where a plan filed under Section 11 (e) of the Act provides for action ordered to be taken under Section 11 (b), and is a suitable means of achieving results which are necessary to effectuate the requirements of that section, *held* that the plan is "necessary to effectuate the provisions of" Section 11 (b) within the meaning of Section 11 (e).

Meaning of "Fair and Equitable" Standard in Section 11 (e)

Where Section 11 (b) (2) requires corporate simplification by means of liquidation, the "fair and equitable" standard requires the distribution of assets to preferred and common stockholders on the basis of legitimate investment values existing apart from the duty of liquidation.

Application of "Fair and Equitable" Standard in Section 11 (e) to the Proposed Distribution of Assets

Under the particular circumstances presented, the "fair and equitable" standard requires disapproval of an allocation to the common stock of in excess of approximately 5% of the assets to be distributed where such common stock has only a possibility of participation in future earnings.

APPEARANCES:

Louis F. Davis, John W. Christensen and Charles Futterer for the Public Utilities Division of the Securities and Exchange Commission.

[fol. 4] Donald Richberg, of Washington, D. C., John Dern and Robert A. Olson, of Chicago, Illinois, for The United Light and Power Company.

Arthur S. Dayton, of Charleston, West Virginia, for Koppers Company.

The United Light and Power Company ("Power") and its subsidiary company, The United Light and Railways Company ("Railways"), both registered holding companies, have filed with the Commission joint applications and declarations, designated as "Application No. 14", pursuant to Sections 11 (b) and 11 (e) of the Public Utility Holding Company Act of 1935 ("the Act") for approval of a plan designed to effectuate the dissolution of Power in compliance with our order of March 20, 1941.[1] In summary, the plan provides for the contribution of cash and minor investments of Power to Railways, and the distribution of Power's remaining asset consisting of all the outstanding common stock of Railways among the preferred, Class A and Class B common stockholders of Power, after which Power will be dissolved.

After appropriate notice, hearings were held on the plan. Applicants waived their rights to oral argument, to submit requests for findings of fact, and to file briefs with respect to the issues raised in the proceeding. Having considered the record, the Commission makes the findings hereinafter set forth.

Brief Description of Applicants

The Power holding company system, as constituted as of November 1, 1942, is shown in the corporate chart attached as Exhibit A. Power, the top company in the system, is solely a holding company owning as its chief asset all the common stock of Railways, also solely a holding company. Following is a condensed corporate balance sheet of Power, per books, as of April 30, 1942.

[1] *The United Light and Power Company*, Holding Company Act Release No. 2636.

[fols. 5-6]

The United Light and Power Company

Condensed Corporate Balance Sheet as of April 30, 1942

Assets			
Investments:			
Railways Common Stock		$72,596,138	
Directly Owned Operating Subsidiaries:			
La Porte Gas and Electric Company	$2,462,535		
Mason City and Clear Lake Railroad Company	1,309,491		
	$3,772,026		
Less: Reserve	352,792	3,419,234	$76,015,372
Deferred Charges			161,680
Special Deposit in Escrow			1,358,442a
Current Assets:			
Deposit for payment of principal and interest on debentures payable 5/1/42		$2,976,186b	
Other (principally cash of $534,080)		647,395	3,623,581
Total Assets			$81,159,075
Liabilities			
Capital Stock:			
Class A Preferred — 600,000 shares — (Liquidation Value $100 per share)		$60,000,000c	
Common (stated value $4 per share):			
Class A — 2,421,192 shares	$9,684,768		
Class B — 1,055,576 shares	4,222,304	13,907,072	$73,907,072
Current Liabilities:			
Bank Note Payable		$3,000,000d	
Debentures (Principal and Interest)		2,976,186b	
Miscellaneous		156,790	6,132,976
Reserve for Depreciation of Investments			2,962,859
Surplus (Deficit)			(1,843,832)
Total Liabilities			$81,159,075

a This sum, equal to the premium payable on voluntary redemption of the debentures, was deposited in escrow with Central Hanover Bank and Trust Company, in accordance with our order of February 25, 1942, and will be returned to Power or its assignee unless it is determined on review of our order that the debenture holders are entitled to receive the premium. On November 12, 1942 the United States Circuit Court of Appeals, Second Circuit, affirmed our order that the premium should not be paid. *The New York Trust Company* v. *Securities and Exchange Commission*, 131 F. 2d, 274 (C. C. A. 2d, 1942). The Trust Company petitioned the United States Supreme Court on February 27, 1943 to grant a writ of certiorari. In the event such petition is denied, or, if granted, the decision of the Circuit Court is affirmed, the funds in escrow will thereupon become available to Power and, under the plan, will be assigned to Railways.

b Deposited with Trustees on February 25, 1942 for payment of principal of and interest on debentures.

c Cumulative preferred stock dividends in arrears amounted to $36,300,000 as of April 30, 1942 and $38,700,000 as of December 31, 1942.

d This note was reduced to $1,500,000 during December 1942.

[fol. 7] Railways, the common stock of which is wholly owned by Power, owns securities of companies which operate, or which control additional companies which operate, gas and electric utility and certain non-utility properties located in scattered areas of the middle western and north central sections of the United States. By reason of this geographical scatteration, the system is at variance with the integration standards prescribed by Section 11 (b) (1) of the Act. Similarly, the existence of several tiers of holding companies in the system is repugnant to the "great-grand-father" clause and other requirements of Section 11 (b) (2). Accordingly, we have previously issued orders to various of the system companies directing action which we considered appropriate under both Sections 11 (b) (1) [2] and 11 (b) (2),[3] reserving jurisdiction, however, to continue proceedings under such sections and to enter such further orders as may be necessary or appropriate.

Detailed description of the substantial progress already made in carrying out our orders under Section 11 (b) (1) [4] and Section 11 (b) (2) [5] is not necessary here. It is sufficient for our present purposes to state that the plan under consideration represents only a part of a long-range program for effecting compliance with Section 11 (b) of the Act and is the final step in fulfilling the portion of our order of March 20, 1941 requiring the liquidation and dissolution of Power.

---

[2] *The United Light and Power Company*, Holding Company Act Release No. 2923.

[3] *The United Light and Power Company*, Holding Company Act Release No. 2636.

[4] These steps were briefly reviewed in *The United Light and Power Company*, Holding Company Act Release No. 3741 and were described in detail in Holding Company Act Releases Nos. 2991, 3316, 3667, 3688 and 3892.

[5] Transactions already completed and steps remaining for consumption were referred to briefly in *The United Light and Power Company*, Holding Company Act Release No. 3438; and were more fully described in Holding Company Act Releases Nos. 2991, 2819, 3140, 3198, 3242, 3285 and 3345.

The Proposed Plan

Briefly stated, the plan provides for (1) the distribution of Railways' common stock, all owned by Power, to [fol. 8] Power's preferred and common stockholders; (2) the assumption of Power's liabilities by Railways; and (3) the transfer of Power's remaining assets to Railways, following which (4) Power will be dissolved.

Prior to the distribution of Railways' common stock and in aid of such distribution, the authorized common stock of Railways, now consisting of 1,000,000 shares having a par value of $35, will be increased to 4,000,000 shares with a par value of $6, each share to have one vote. The outstanding 708,520 shares of Railways' common stock will then be exchanged by Power for 3,947,677 shares of Railways' new stock. The proposed change in the par value of Railways' common stock will reduce the amount of capital represented by such stock outstanding from $24,798,200 to $23,686,062 and the difference of $1,112,138 will be credited to Railways' paid-in surplus account.

Following the above-described exchange, the plan provides that the new common stock of Railways be allocated to Power's security holders, in full compensation for their claims against Power, on the basis of 6 shares for each present share of Power's preferred stock, 1/10 share for each present share of Class A common stock and 1/10 share for each present share of Class B common stock of Power.[6] In lieu of fractional shares it is proposed that non-interest bearing, non-dividend bearing and non-voting scrip, in bearer form, will be issued; scrip in amounts sufficient to aggregate one or more full shares may be surrendered in exchange for full shares of Railways' common stock. The plan provides that the right of Power's stockholders to receive either common stock or scrip of Railways shall ex-

[6] Except as to voting rights, all of which are now vested in the Class B common, the Class A and B common stocks of Power are entitled to the same rights. For this reason the two classes of common stock will be considered together in our discussion of the fairness of the plan. The record shows that Power's common stocks, having an aggregate stated value of approximately $13,911,000, were issued for a total consideration of $28,482,745 of which approximately $17,121,000 represented cash.

pire July 1, 1944, after which date the scrip shall be void. All shares of Railways' common stock remaining unclaimed [fol. 9] as of this date shall be disposed of either at public or private sale and cash shall be distributed to the remaining stockholders of Power on the basis of their aliquot portion of the net proceeds of such sale plus any other cash from dividends or distribution which may be applicable to the common stock of Railways which may be sold.

The proposed exchange of securities will result in a distribution of Railways' new common stock as follows:

To Stockholders of Power	Outstanding Shares of Power (4/30/42)	Number of Shares of Railways' New Common To be exchanged for each share of Power stock	To Be Outstanding	Percent of Allocation of Railways' Common Stock
Preferred	600,000	6 for 1	3,600,000	91.20%
Class A Common	2,421,192	1 for 10	242,119	6.13
Class B Common	1,055,576	1 for 10	105,558	2.67
Total	4,076,768		3,947,677	100.00%

In accordance with our orders of August 5, 1941 and January 5, 1942[7] requiring disposition by Power of its investments in its directly owned operating subsidiaries, La Porte Gas and Electric Company ("La Porte") and Mason City and Clear Lake Railroad Company ("Clear Lake"), Power has attempted to sell these companies. Negotiations are at present in progress with respect to La Porte but a purchaser for Clear Lake has not yet been found. Under the plan it is proposed to retire Power's bank loan, in the [fol. 10] amount of $1,500,000, out of the proceeds from the sale of La Porte. In the event this sale is not consummated within the time scheduled for liquidation, Power's invest-

[7] *The United Light and Power Company*, Holding Company Act Releases Nos. 2923, 3242 and 3285.

ment in La Porte will be transferred to Railways, and appropriate arrangements will be made to provide for Power's bank loan and any remaining liabilities, including the expense of liquidation. The investment in Clear Lake and the remaining cash of Power will also be transferred to Railways as a capital contribution.[5]

The present voting rights of the stockholders of Power will not be affected by the plan until the date of distribution of Railways' common stock, at which time all voting rights in the stock of Power will cease and terminate. After the distribution date the present stockholders of Power will exercise the voting power which will attach to the Common shares of Railways to be received by them under the plan.

Power has requested the Commission, pursuant to Section 11 (e) of the Act, to apply to a Federal Court to enforce and carry out the provisions of the plan if and as approved by the Commission. If the Court approves the plan, the distribution of Railways' common stock and scrip to the stockholders of Power is to be made on or after the thirtieth day following the date on which the court decree becomes final and is no longer subject to review on appeal. Thereafter Power will be dissolved. The plan does not provide for approval by stockholders.

Compliance With Section 11 (e) of the Act

As a condition precedent to granting our approval of a plan such as this we are required by Section 11 (e) of the Act to find (1) that the plan is necessary to effectuate the provisions of Section 11 (b) and (2) that the plan is fair and equitable to the persons affected by it.

[fol. 11] *Necessity for the Plan*

We encounter no difficulty in making the first of these required findings. The plan provides for the liquidation and dissolution of Power, which we have previously found necessary under Section 11 (b) (2) of the Act, and dissolution is to be preceded by the elimination of Power's stock

[5] Power's investment in Clear Lake, now carried at a net amount of $591,154, is to be recorded on the books of Railways at $150,000 as a result of a proposed write-down by Power in the amount of $441,154.

liability through a distribution of assets in kind, a method we believe to be both economical and appropriate to effecing compliance with the standards of Section 11 (b) of the Act.

Fairness and Equitableness of the Plan

The second required finding, namely, that the plan is "fair and equitable to the persons affected by such plan," presents a more difficult problem. The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942.

Attached hereto as Exhibits B and C are corporate and consolidated balance sheets of Railways, as of April 30, 1942, per books and pro forma reflecting consummation of the proposed transactions. These balance sheets indicate a pro forma book value of $77,954,874 for Railways' common stock on a corporate basis and $81,554,330 on a pro forma consolidated basis. Thus present book values of assets pro forma are clearly insufficient to cover the liquidation preference of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise[9] we are unable to find an over-all value for the assets which approaches $98,700,000.

We are constrained to reach this conclusion as to asset values despite valuation testimony in the record including a study prepared, on behalf of the management, by an [fol. 12] engineer who derived an over-all value of $104,172,231, as of December 31, 1939, based upon a method involving the capitalization of his estimate of the earning power of the system. The company brought this valuation down to April 30, 1942, arriving at an over-all value of $110,000,000.

We have carefully considered the valuation study made by the engineer and without commenting in detail upon the propriety of the methods used, it is our opinion that

---

[9] It is clear that capitalization of prospective earnings, rather than book values, is the principal criterion of asset value. *Consolidated Rock Products v. DuBois*, 312 U. S. 510.

the over-all valuation arrived at by the engineer must be rejected.[10] Our reasons for rejecting his valuation include consideration of the fact that we are here dealing with a regulated industry and that current trends in regulation place increased emphasis on depreciated cost of properties which, as indicated by the book values, is substantially less than the liquidation preference of the preferred stock. In order to show a value of as much as $98,700,000, it would be necessary to capitalize 1942 consolidated net earnings applicable to the common stock of Railways (the highest earnings since 1931) at a rate of 6.9%, a times-earnings

---

[10] In making his study, the engineer first estimated the reasonably expected gross income of each subsidiary operating company. These estimates closely approximated estimates of sound earning power made by the management in a study completed in 1939. As the next step, the engineer calculated a return of 6% on an estimated earnings base computed for each company by taking estimated reproduction cost new less observed depreciation and adding thereto estimated necessary working capital. Following these steps, the computed return on the estimated earnings base was compared with estimated gross income and whichever earnings figure was lower in amount for each company that figure was capitalized at rates varying from 5.5% to 6% for electric and 6% to 7% for gas revenues. If, in this comparison, gross income exceeded the computed return on the estimated earnings base, the excess was capitalized at 10%. Gross income from transportation and miscellaneous services was capitalized at from 8% to 10%. The variation in capitalization rates used in the study was based upon a judgment as to the integrity of earning power as related to the character of the individual companies and the territory served, earnings history, population trends, competition, rates and other factors considered relevant. From the capitalized value obtained in the foregoing manner there was deducted an amount deemed necessary for materials, supplies and working capital, the remainder representing the estimated value of utility plant. This value was substituted for the net property accounts in the balance sheets of the various companies after which the over-all value of the ultimate holding company interest was computed in the usual manner for determining book equity.

ratio of 14.5. Even if the most liberal estimate of earnings made by the management, in the amount of $7,000,000, be taken as the measure of prospective earning power, cap- [fol. 13] italization of such earnings at a rate producing a times-earnings ratio of 14.1 is necessary to reach an overall value of $98,700,000. Further discussion of historical and prospective earnings appears below. In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference.[11]

If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common. Power's corporate charter provides that the liquidation preference of this stock shall come into operation in the event of "involuntary" liquidation. While the liquidation in this case is doubtless "involuntary," it is of a type that could not have been foreseen by the draftsmen of the corporate charter or by investors in the stock,

---

[11] Without wishing to overemphasize the significance of market quotations in dealing with problems of valuation, we note that the times-earnings ratio at which 1942 consolidated net earnings must be capitalized, in order to find a value of as much as $98,700,000, is considerably in excess of the ratio the market, over the past five years, has placed on the common stocks of nine representative public-utility holding companies. The companies selected are all free of preferred dividend arrearages. The average times-earnings ratios (based on consolidated earnings) for these companies were as follows:

1937	12.5
1938	10.3
1939	10.1
1940	8.8
1941	6.5
1942	5.1
1943	7.1
Average for 4 years—1937-1940—	10.4
" " 5 " —1937-1941—	9.6
" " 6 " —1937-1942—	8.9

long before the enactment of the Holding Company Act.[12] [fol. 14] The question, then, is whether or not it would be "fair and equitable", in light of the legislative purpose and policy underlying Section 11 of the Act, to give controlling effect to that charter provision under the circumstances.

We have found no judicial precedents which are determinative of the precise question before us. Decisions like those in the Los Angeles Lumber[13] and Boyd[14] cases are predicated on sets of facts fundamentally distinguishable from the situation arising here. In bankruptcy or equity reorganizations, where some financial disaster overtakes or threatens to overtake an enterprise, the courts and Congress have proceeded on the theory that it is often in the interest of creditors and other claimants that the enterprise be permitted to continue in operation, but with a new capital structure. Creditors and other claimants are prevented from foreclosing or otherwise compelling an actual liquidation, but new securities are distributed among them according to their contractual and other rights determined *as though in liquidation*. The historical background of this approach is so familiar as to need no elaboration here.

On the other hand, Power is a company virtually without debt and under no financial embarrassment in the traditional bankruptcy or equity sense. Since it falls into a category of holding companies which Congress has determined must *not* be permitted to continue in operation, in

---

[12] The preferred stock was created in 1929, six years prior to the passage of the Act. We think that involuntary liquidation, in the context in which that term is used in the corporate charter, connotes an act of default, either financially or in respect of conduct, on the part of the corporate management representing the common stock. In short, it contemplates protection of the preferred stock from business risks such as ordinarily attend equity investment. We do not, however, rest our decision upon this interpretation, as will be more fully developed *infra*, but only point out that the draftsmen of the charter could not have had Section 11 of the Act in mind.

[13] *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106.

[14] *Northern Pacific Railway Co. v. Boyd*, 228 U. S. 482.

the interests of the public, investors and consumers, the company's security holders are prevented from maintaining their respective interests in a going corporation. In our view, it is not inconsistent with the bankruptcy and equity precedents to conclude that in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation [fol. 15] preferences. In both instances the measure of participation allowed should compensate for the substantive rights of security holders as they would exist apart from the reorganization or other procedure in question.

In the case before us, the duty to liquidate arises solely by virtue of a sovereign act, and in giving effect to the Congressional mandate we must not allow the liquidation itself to add value to one class of securities at the expense of another class.[17]

Where simplification of a system is to be attained through elimination of an unnecessary corporate entity, it is our opinion that the "fair and equitable" standard does not require us to consider liquidation rights as having matured, and as the sole measure of participation for the preferred stockholders; and it should be immaterial whether the simplification process takes the form of recapitalization, merger or distribution of the assets of a holding company in liquidation. In other words, the "fair and equitable" standard requires the same recognition of substantive rights irrespective of the method employed in a particular case for attaining the objectives of Section 11 (b) (2).

---

[17] Cf. *The United Light and Power Company*,—S. E. C. — (1942), Holding Company Act Release No. 3345 (aff'd *The New York Trust Co. v. S. E. C.*, 131 F. (2d) 274 (C. C. A. 2d, November 12, 1942), in which we applied this reasoning to the liquidation of Power's debentures at par and accrued interest without premium. Our decision was based on the absence of any provision in the debenture agreements giving the holders a contract right to a premium under the circumstances presented. Thus we were not called upon to decide, and did not consider, what effect would be given to such a contract right if it had existed.

More specifically, if a class of preferred stock has a measurable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of [fol. 16] that interest through the operation of the statutory mandate.[15a]

Clearly the intent of Congress was that the techniques employed under Section 11 should be those necessary to remove the holding-companies' concentration of economic power over operating utilities, promote local management and regulation for the benefit of consumers, eliminate unnecessary and uneconomic corporate entities, and benefit investors generally by giving them more direct interests in the operating properties and earnings *to the extent that their holding-company securities represent any real equity therein.*[16] The liquidation of Power accomplishes an im-

---

[15a] This conclusion seems to us in no way inconsistent with the Commission's position as to the right of bondholders to a premium on liquidation, nor with the implications of the various cases arising under the Anti-Trust Acts which are referred to in the dissenting opinion. Interpretation of contract provisions is of course a necessary starting point for evaluating interests. There remains the question of what may be fair and equitable in the light of the entire bundle of contractual rights.

[16] That this process was not to operate so as to destroy values was emphasized repeatedly. For example, in reviewing the integration and simplification provisons of the Senate bill, the report of the Committee on Interstate Commerce points out that one means of compliance would be for holding companies: "to distribute their securities and assets equitably among their security holders. Precedents under the Sherman Antitrust Act and under the Hepburn Act demonstrate that the necessary corporate adjustments can be made without forced liquidation or the sacrifice of legitimate investments values." Sen. Rep. No. 621 (74th Cong. 1st Sess.) at p. 33. It is clear from the context that

portant step in this direction by giving the preferred and common stockholders a security that is better than those they have heretofore held. This process of improvement of position must not be permitted to destory any legitimate interests of the common stock, or present a windfall to any [fol. 17] senior security. Where such an inequitable result would be reached by borrowing bankruptcy techniques for assessing the claims involved, we must reject bankruptcy techniques as inappropriate under the circumstances; and we think it logical enough that they should be inappropriate here, since the situation before us is (as we have seen) not comparable to the situation found in bankruptcy.[17]

"forced liquidation" as used by the Committee meant forced sales.

Congressman Eicher (later Chairman of this Commission and now Chief Justice of the District Court of the United States for the District of Columbia), discussing the same bill (S. 2796), expressed his views and the views of other members of the House Committee in these terms:

> "But Section 11 of the Senate bill would give fair assurance that what is left of the investor's equity would not hereafter be taken from him and it would give fair assurance that any legitimate increase in value of the underlying properties would go to investors * * *
>
> "There is nothing in Section 11 of the Senate bill which will hurt any legitimate investment interest. It does strike and strike hard at that dangerous concentration of economic power which resides in the holding company." H. Rep. No. 1318 (74th Cong. 1st Sess.) at p. 51.

In so far as pertinent to this question, the purposes of Section 11 in the final enactment coincided with those of the Senate Bill. See H. Rep. No. 1903 (74th Cong. 1st Sess.) at pp. 65, 68-71.

---

[17] Indeed, the legislative history of the Act appears to recognize the inapplicability of precedents in bankruptcy. See the statement of the Senate Committee, footnote 16 *supra*.

Earlier in the same report the Committee spoke of the courts exercising "all the extraordinary powers such courts

It is pointed out in Commissioner Healy's separate opinion that the words "fair and equitable" embodied in Section 11 have a settled meaning, as determined by the courts, and that an application of the "absolute priorities" doctrine must result in no distribution to Power's common stock in this case. But that is because he measures the rights of the preferred stock as they would be measured in bankruptcy cases, and not merely because he follows the "absolute priorities" doctrine in determining the consequences of the measurement. In other words, we can agree with him when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and [fol. 18] priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold.

---

have been accustomed to exercise when called upon under the Sherman and Hepburn Acts to effect compulsory corporate readjustments required by the public policy expressed in those acts." Id., at p. 13.

And further:

> "* * * The process of compulsory divestment of control is left to the Federal courts, without time limit, for the applications of the technique worked out in the dissolution under the Sherman Act and the Hepburn Act (commodities clause).
>
> "The title provides that during all court processes the Securities and Exchange Commission shall act as an impartial expert economic adviser and administrative assistant to the courts. That expert assistance will enable the courts to save time and expense in the solution of essentially economic and administrative problems for which in the Sherman Act cases it had no assistance except that of opposing counsel. But the courts can take such time as they deem advisable to dispose of assets without sacrifice." Id., at p. 14.

It is our conclusion that we must judge the fairness of the plan according to legitimate investment values existing apart from the duty of liquidation imposed by the statute. The existence of the liquidation preference does, of course, enter into the question as it is one of the bundle of rights belonging to the preferred stock and affecting its normal value. The preference itself, however, will not be permitted to operate so as to be conclusive in the division of assets between the preferred and common stocks.[18]

By the foregoing we do not imply that compensation should or can be given in eliminating any "rights" which are proscribed by the statute as being unfair, such as the naked "right" to exercise a voting power which is inequitable under the statutory standards or the "right," by misuse of power, to delay or prevent compliance with the statute. The "legitimate investment value" to be accorded recognition may include those rights and expectancies which, although possibly predicated on an unsound or economically undesirable structure, are not inherently unfair. An example is the interest of the common stock in net income over and above fixed amounts applicable to senior securities—where there is a reasonable chance of such income. Although it is repugnant to the policies of the Act to have the corporation continue in operation, the common stockholders' interest in the earnings of Power's assets is not for that reason proscribed. The limitation of the preferred stock dividend to a fixed amount, [fol. 19] is a valuable right vested in the common stock; and the value of such right, in light of the earning capacity of Power's assets, may be recognizable even though it would take a number of years, in the absence of liquidation, for dividends to be payable to the common stock. The accumu-

[18] This is the first instance in which we have been called upon to decide this precise question. To the extent that our conclusion is at variance with *dicta* in previous cases, such *dicta* are overruled.

For example in *Federal Water Service Corp., et al.*, 8 S. E. C. 893 (1941), we intimated that in a liquidation required under Section 11 (b) (2) the rules applicable to a bankruptcy reorganization proceeding would be applicable (p. 910). That case did not involve liquidation of any kind, and the language referred to was not necessary to the decision.

lation of preferred dividend arrearages does not constitute a matured claim in the absence of liquidation, and does not require compensation to the preferred stockholder for the lapse of time which may precede payment.

To accelerate the arrearages and translate them into matured claims at their full face amount, so as to entitle the preferred stock not only to all the assets but also in perpetuity to the entire earning power of those assets—a portion of which would otherwise have been applicable to the common stock—would clearly be to enrich the preferred at the expense of the common.

Under the circumstances, fair and equitable compensation will be given to all of the claimants if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i. e., as though no liquidation were to take place. In this way each class of stock will be accorded its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system.

In approaching the problem of passing upon the fairness of the proposed plan in the light of the principles discussed, it is our view that it is unnecessary to arrive at any specific over-all value for the enterprise or for the preferred and common stocks of Power. We are required, however, to examine into the respective existing interests of the preferred and common stockholders in the earnings of the enterprise. The valuation of interests such as these is not an exact science, even in the most favorable circumstances. Presented with a proposed allocation of assets such as that suggested here, the best we can do is to deter- [fol. 20] mine what assumptions are necessary to arrive at the allocation, and ascertain whether such assumptions fall within the permissible limits of reasonableness.

The following tabulation sets forth the corporate and consolidated net income per books applicable to the preferred and common stock of Power, the preferred dividend requirements and the balance of consolidated net income applicable to Power's common stock, for the period from 1929 [19] through 1942.

[19] The presently outstanding 660,000 shares of preferred stock were issued during 1929 and 1930.

[fols. 21-22]

Years Ended December 31	System Net Income Before Power's Preferred Dividend Requirements		Power's Preferred Dividend Requirements	Consolidated Balance (Deficiency) Applicable to Common Stock of Power
	Corporate	Consolidated		
1929	$2,663,602	$9,971,641	$2,469,505 (a)	$7,502,136 (b)
1930	6,212,264	10,462,450	3,568,613 (a)	6,893,837 (b)
1931	6,956,991	7,819,382	3,600,000 (a)	4,219,382 (b)
1932	4,582,947	4,171,925	3,600,000 (c)	571,925
1933	1,233,591	1,510,925	3,600,000	(2,089,075)
1934	663,188	986,719	3,600,000	(2,613,281)
1935	311,268	2,411,652	3,600,000	(1,188,348)
1936	121,851	4,508,261	3,600,000	908,261
1937	402,139	5,182,602	3,600,000	1,582,602
1938	627,594	3,091,508	3,600,000	(508,492)
1939	2,342,432	4,598,654	3,600,000	998,654
1940	2,365,832	5,266,602	3,600,000	1,666,602
1941	930,813	4,134,544	3,600,000	534,544
Total of 13 yrs.	$29,414,512	$64,116,865	$45,638,118	$18,478,747 (e)
1942 Estimated	1,200,000	6,700,000 (d)	3,600,000	3,100,000
	$30,614,512	$70,816,865	$49,238,118	$21,578,747

a Preferred dividend paid during these years.
b During these years the following common stock dividends were paid:

1929	$1,841,937
1930	3,441,262
1931	3,469,597

None thereafter.

c $900,000 or one-fourth of the annual requirements was paid in 1932.
d Before provision for $160,000 fixed charges on Power's debentures paid on May 1, 1942.
e In contrast, the consolidated surplus at December 31, 1941 was zero. The reduction has resulted from the provision for and the elimination of losses during past years.

[fol. 23] Power's corporate income, as shown in the table, has never equalled the annual preferred requirements since 1932. Consolidated earnings for the period 1929 through 1942, however, as may be noted, present a different picture, showing a net balance applicable to the common stock. It will be seen that indicated undistributed consolidated earnings for the fourteen-year period amounted to $51,525,951 of which $38,700,000 is applicable to Power's preferred stock and the balance of $12,825 951 is applicable to Power's common stock.

Power has urged that consolidated earnings rather than corporate earnings should be considered of paramount importance in estimating the potential earning power of the system. A number of factors are cited in the record in support of the soundness of consolidated earnings, including the relative absence of inflationary items in the system companies' property accounts, the moderate amount of

preferred stocks in the operating companies and their freedom from dividend arrearages, the fact that the flow of current earnings is not impeded by the existence of restrictions on the earned surplus accounts of the underlying companies and the relative adequacy of depreciation reserves and current annual provision for depreciation and maintenance compared to the average for the industry.[20] While the company has urged the soundness of consolidated earnings it has pointed out that considerations of tax lia- [fol. 24] bility and good management made it inadvisable in the past to pay up the major portion of consolidated earnings to Railways and Power.[21] At the same time the

---

[20] Annual provision for depreciation and retirements by each of the 9 major public utility subsidiaries for the year ended April 30, 1942, ranged from a low of 5.9% of gross revenues to a high of 12.3%, the average being 8.9%. In terms of gross plant and property the provision for depreciation and the retirements ranged from 1.54% to 3.27% for an overall average of 2.33%. The record shows that the depreciation rates applied by the system companies are substantially in line with those approved for federal income tax purposes. The combined provisions for maintenance, depreciation and retirements for the year ranged from a low of 9.5% of gross revenues to a high of 18.9% for an average of 13.6% for the 10 companies.

The record indicates that the ratio of depreciation reserve to plant and property as of April 30, 1942 ranged from a low of 13.6% to a high of 26.2%, the average for the 9 major public utility subsidiaries being approximately 20.5%. In comparison, the average ratio for 210 electric and gas subsidiaries of registered public utility holding companies as of December 31, 1941, was 13.64%.

Nothing in this opinion shall be construed as a finding with respect to the adequacy or inadequacy of reserves for depreciation or of annual provisions for depreciation and maintenance.

[21] The record shows that earnings have been largely retained to be applied to protect and strengthen the equity of Railways' common stock of Power's preferred and common stock. During the 10-year period from 1932 through 1941 the system has had undistributed consolidated net income amounting to $33,237,000 and has realized cash from

management has expressed the view that the system will be able, in the future, to draw up from its subsidiaries a larger percentage of their earnings than in the past. Further simplification of the obviously top-heavy superstructure of the system, now in progress, may be expected to provide substantial aid in facilitating this upward flow of dividends. The management, however, has made no precise statement as to when, or in what amounts, it can be expected that dividends will be paid on Railways' new common stock.

It will be seen that the consolidated earnings have fluctuated widely over the 14-year period covered by the table. It should also be noted that the consolidated earnings reported for the years 1929, 1930 and 1931 are of questionable usefulness as an index of earning power due to the inclusion therein of items such as profits from dealing in the system's own securities and income from call loans.

Consolidated earnings during the ten years from 1932 through 1941 approximately equalled the preferred dividend requirements. The management disputes the propriety of using the results of this period, however, as a fair measure of the system's potential earning power under normal conditions. In support of its contention there have been cited the adverse effects of the depression in the earlier years of this period, the unusual expense incidental to the substitution of natural for manufactured gas, the [fols. 25-26] cost of retiring railway transportation facilities replaced by bus service, and the reduction of fixed charges and preferred dividend requirements resulting from the relatively recent use of system earnings in substantial amounts to retire debt and preferred stocks senior to the preferred and common stock of Power and the common stock of Railways. The management argues that earnings subsequent to 1936 constitute a more reliable

---

the sale of assets ($36,260,000), from depreciation accruals ($83,595,000) and from amortization charges ($8,694,000). Of the aggregate of these amounts ($161,786,000), $157,684,000 has been used as follows: $108,562,000 for property additions; $19,414,000 for long-term debt reductions; $4,667,000 for preferred stock reduction; $4,780,000 for reduction of minority interests in system companies and $20,261,000 to increase net current assets.

measure of prospective earning power than either earnings for the 13-year or the 10-year period prior to 1942.

In considering the earnings subsequent to 1936 the management has contended that adjustments should be made to reflect the earnings of the system as constituted at a relatively recent date and to restore certain "non-recurring" expenses charged to earnings during the period. Effect is given to these contentions in the following table of earnings for the system as of April 30, 1942, the most recent practicable date for which financial information could be supplied at the time the plan was filed.[22] The table also includes a statement of earnings for 1942 based on 9 months' actual and 3 months' estimated operations.

[fols. 27-28]

The United Light and Railways Company
Comparative Consolidated Net Income Applicable to
Railways' Common Stock for the Years 1937 through 1942

Period	Consolidated Net Income of Power Before Power's Preferred Dividend Requirements	Amount Applicable to Common Stock of Railways Adjusted for System as Constituted at April 30, 1942	Adjustments* for Non-recurring Expenditures Netted for Income Taxes	Adjusted Consolidated Balance Applicable to Common Stock of Railways
1937	$ 5,182,602	$ 5,856,311	$ 556,643	$ 6,412,954
1938	3,091,508	3,962,314	749,095	4,711,409
1939	4,598,654	5,118,375	922,575	6,040,950
1940	5,266,602	5,772,567	1,091,483	6,864,050
1941	4,134,544	4,906,879	1,064,738	5,971,617
Total of 5 years	$22,273,910	$25,616,446	$4,384,534	$30,000,980
1942 (9 mos. actual; 3 mos. est.)		6,874,277	232,012	7,106,289
Total of 6 years		$32,490,723	$4,616,546	$37,107,269
5 year average (1937-1941, incl.)		$ 5,123,289	$ 876,906	$ 6,000,196
6 year average (1937-1942, incl.)		5,415,120	769,425	6,184,545

*These include adjustments for non-recurring expenditures urged by the management as necessary to a determination of the normal earning power of the

[22] It should be understood that the consolidated adjusted earnings applicable to the common stock of Railways, as shown in the table, are substantially equivalent to those which would be applicable to the preferred and common stock of Power since upon consummation of the plan, involving the contribution of all assets of Power (other than Railways' common stock) to Railways, the earning power of Railways will be identical with that of Power.

[fol. 29] As shown in the table consolidated earnings applicable to the common stock of Railways, adjusted as suggested by the management, averaged $6,000,196 for the 5-year period 1937-41, inclusive, and $6,184,545 for the 6-year period 1937-42, inclusive. To reach these amounts, adjustments must be made, as noted in the table, for "non-recurring" expenses in substantial amounts. While there is serious doubt as to the propriety of adding back a number of these items, probably some recognition must be accorded to the benefits inuring to the system as a result of these expenditures. In addition, there may be a question as to the weight to be given to reported earnings to the extent that they reflect savings in taxes deriving from losses to the system during these years; to the extent that normal tax liability was materially minimized through losses of a "non-recurring" nature, the earnings would be correspondingly overstated.

With respect to future earnings prospects, Harry B. Munsell, Vice-President of Power, testified at the hearings that in the opinion of the management the earning power of the system under normal conditions would provide an annual consolidated net income of between $6,500,000 and $7,000,000 which would be applicable to Railways' common stock and hence to the preferred and common stocks of Power. This estimate of prospective income appears optimistic, being higher than any in the last ten years, and very materially in excess of the average for that period. While consolidated earnings in 1942 support the manage-

---

system. The charges in question fall generally into two classifications, i. e., (1) expenditures of an unusual nature which should not ordinarily be repeated and (2) charges for amortization which do not represent current cash expenditures or depreciation of properties. In the former category are charges of substantial amounts representing expenses in connection with certain appraisal and rate case matters before regulatory commissions. Although it cannot be predicted that such cases will not arise in the future, the management points out that the substantial amounts already spent and the progress made in reclassifying the property accounts in all the system companies on an original cost basis, together with the fact that continuing property inventory records are kept by the system companies, militate against the recurrence of expenditures of this sort in any large amounts. Illustrative of charges in the latter category are those for amortization of plant acquisition adjustments and for amortization of street railway property abandonments. The management urges that while charges of this type, when made, constitute bookkeeping deductions against income available for dividends, the application of cash generated pursuant to such amortization programs results in no decrease in asset value, but rather improves the quality of the investment of security holders by transposing intangible items into tangible ones and enhances earnings. In connection with non-recurring credits to income, the management represents that no such credits of any important magnitude are included in the record of earnings set forth above, it having been the practice of the system to credit any important non-recurring credits directly to earned surplus rather than to earnings.

ment's estimates, it should be borne in mind that the comparable actual figure in 1941 was $4,906,879. The increase in consolidated earnings to approximately $6,800,000 in 1942 resulted principally from income and excess profits tax savings made possible under the Revenue Act of 1942 which permits the filing of consolidated income tax returns for normal and surtax purposes as well as for excess profits tax purposes.

Thus, any judgment as to the reasonableness of earnings approximating those in 1942 as a measure of prospective [fol. 30] income must be made in the light of both a comparison with recent earnings and the savings in 1942 to be derived from filing consolidated income tax returns, considering at the same time the possibility that these savings may be affected in the future by either a change in the tax law or in the security structure of the system. In addition, it should be pointed out that the earnings of some of the underlying subsidiaries may be high in relation to the depreciated cost of properties.

For the purpose of determining the existing rights of the preferred and common stocks in the enterprise, we have assumed earnings of $6,185,000, the average adjusted consolidated income applicable to Railways' common stock for the period 1937-42. However, it must be pointed out that in view of the actual earnings experience and the intangible factors discussed, this figure must be regarded as a very liberal assumption as to earning power.

As of December 31, 1942, the dividend arrearages on the preferred stock totalled $38,700,000. Current annual dividend requirements on such stock amount to $3,600,000. On the basis of the $6,185,000 earnings figure, it would take approximately 15 years for the preferred dividend arrearages to be paid in full, if all consolidated net earnings were to be applied toward the payment of current and accumulated preferred dividends.

Under the assumptions we have stated, it is recognized that at best the interest of the common stock in earnings is remote. Particularly is this true since, as a practical matter, all consolidated earnings would not be available for disbursement to the preferred and common stockholders. The remoteness of the common stock's participation is also demonstrated by the fact that actual earnings have fluctuated substantially and have never in the past ten years exceeded the figure we are assuming, except in 1942. Furth-

ermore, as already noted, we are unable to accept at full value the adjustments to past earnings submitted by the management in support of the allocation provided for in the plan. In view of all these considerations and of all other [fol. 31] factors appearing in the record, we are unable to find that a participation for the common stock as high as the proposed 8.8% falls within the permissible limits of reasonableness for a situation of this kind. We must, therefore, withhold our approval of the plan.

While we have reached the conclusion that the allocation provided for in the plan is too liberal to the common stock, our consideration of all the circumstances leads us to believe that the common stock is nevertheless entitled to some participation. Our conclusion in this respect is of necessity one of over-all judgment and not susceptible of mathematical demonstration. In approaching the problem, we have kept in mind that there is always a margin of error inherent in any estimate of earning power. Under all the circumstances it is our view that a participation for the common of approximately 5%, while representing the maximum, would not exceed the permissible limits of fairness, and to secure our approval the plan must be modified to reduce the common stockholders' participation accordingly.

This conclusion takes into consideration the fact that, to the extent its earnings should perchance exceed those estimated, the common stock, in exchange for an allocation of approximately 5% would be giving up its claim to 95% of any possible excess over the amount necessary to satisfy the dividend preferences of the preferred. In other words, as the participation of the common stock approaches zero it is giving up, in exchange therefor and for the benefit of the preferred stock, nearly 100% of its chance of participating in any future earnings in excess of the existing preferences of the preferred. On the other hand, if earnings do not equal such preferences, the preferred stock gives up but approximately 5% of the earnings actually realized.[23]

---

[23] In considering the possible margin of error inherent in any attempt to forecast future earnings, allowance must be made for the fact that we are dealing with a top company in a pyramided structure. As a result of "leverage" any fluctuations in underlying earnings are greatly magnified in their import upon earnings available for securities of the top holding company.

[fol. 32] Under the circumstances here present, we are unwilling to permit the complete elimination of the common stock. Our conclusion in this regard is reinforced by reason of our belief that the whole future program of corporate simplification and geographic integration of the system, as in the case of the present step in such program, will result in an improvement of the investment position of both the preferred and common stock. That improvement, we believe, should be shared by the common as well as by the preferred, and the process of securing such improvement in compliance with the Act should not be permitted to destroy existing investment values.

We have earlier stated our view that the plan is necessary to effecuate the provisions of Section 11 (b). This finding was, of course, based on the assumption that the plan would be found to be fair and equitable or would be modified so as to meet such requirement. While the plan accomplishes the liquidation and dissolution of Power required by our order under Section 11 (b) (2) of the Act, it makes no attempt to effect a redistribution of voting power in so far as Railway's preferred stock is concerned. This matter will be the subject of consideration at an appropriate time in the pending proceedings under Section 11 (b) (2) of the Act.

As earlier noted, the proposed plan makes no provision for submission to security holders for approval, but the applicants have requested that, upon approval by the Commission, we apply to an appropriate Federal Court to enforce and carry out the terms and provisions of the plan as approved. Under these circumstances we are of the opinion that approval of security holders is not necessary. In order to keep the security holders fully informed and particularly to advise them of the modification in allocation required in order to secure our approval, we shall, by condition to our order approving the plan, if modified as proposed, require Power to make a copy of this opinion available to each of its security holders.

[fol. 33] Our order approving the modified plan shall provide that upon its acquisition of the securities of Clear Lake and of La Porte, if the securities of the latter company are acquired, Railways shall be bound to the same extent as Power, by the prior orders of this Commission directing Power to divest itself of its interest in said companies.

Compliance with Other Provisions of the Act

Prior to granting final approval of the plan as modified, we must find that the individual transactions comprising the plan comply with all other applicable sections of the Act.

As we have noted, the plan contemplates the transfer of the investments in La Porte and Clear Lake from Power to Railways pending their disposition in accordance with our earlier orders. We grant our approval of these transfers under Section 12 of the Act, and the rules promulgated thereunder, and we find that these acquisitions by Railways meet the standards of Section 10. Since these properties are to be retained only temporarily and are to be acquired in conjunction with corporate simplification to be attained through the elimination of Power, the top holding company, we believe that the proposed acquisitions will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system as required by Section 10 (c) (2).

The standards of Sections 6 and 7 are applicable to the new common stock to be issued by Railways in exchange for its presently outstanding common stock. This stock meets the requirements of Section 7 (c) and, having in mind our continuing jurisdiction to examine the corporate structure of the system and to order necessary action under Section 11 (b) (2), no adverse findings are required under Section 7 (d). Also we approve Railways' acquisition and retirement of its present common stock, pursuant to Section 12 (c) of the Act.

[fol. 34] The equity contribution by Power to Railways, consisting of the investments in La Porte and Clear Lake and the excess of current assets to be transferred over liabilities to be assumed, has our approval under Section 12 (b) and Rule U-45. Furthermore, the accounting entries necessitated by the various transactions comprising the plan are approved under the applicable sections of the Act and the Rules thereunder.

Pending final determination of the amounts upon consummation of the plan and completion of the record with regard thereto, we shall reserve jurisdiction to pass upon the reasonableness of all counsel fees.

Conclusion

For the reasons appearing hereinabove, we have concluded that we can approve the plan with the modification as to participation we have noted in this opinion, subject, however, to the several conditions and reservations of jurisdiction indicated. If the company desires to adopt this modification and to request us to apply to a court to enforce and carry out the terms and provisions of the plan, as modified, we will proceed immediately to comply with such request.

By the Commission (Chairman Purcell and Commissioners Pike, Burke and O'Brien), Commissioner Burke filing a separate statement of additional views, and Commissioner Healy filing a dissenting opinion.

Orval L. DuBois, Secretary. (Seal.)

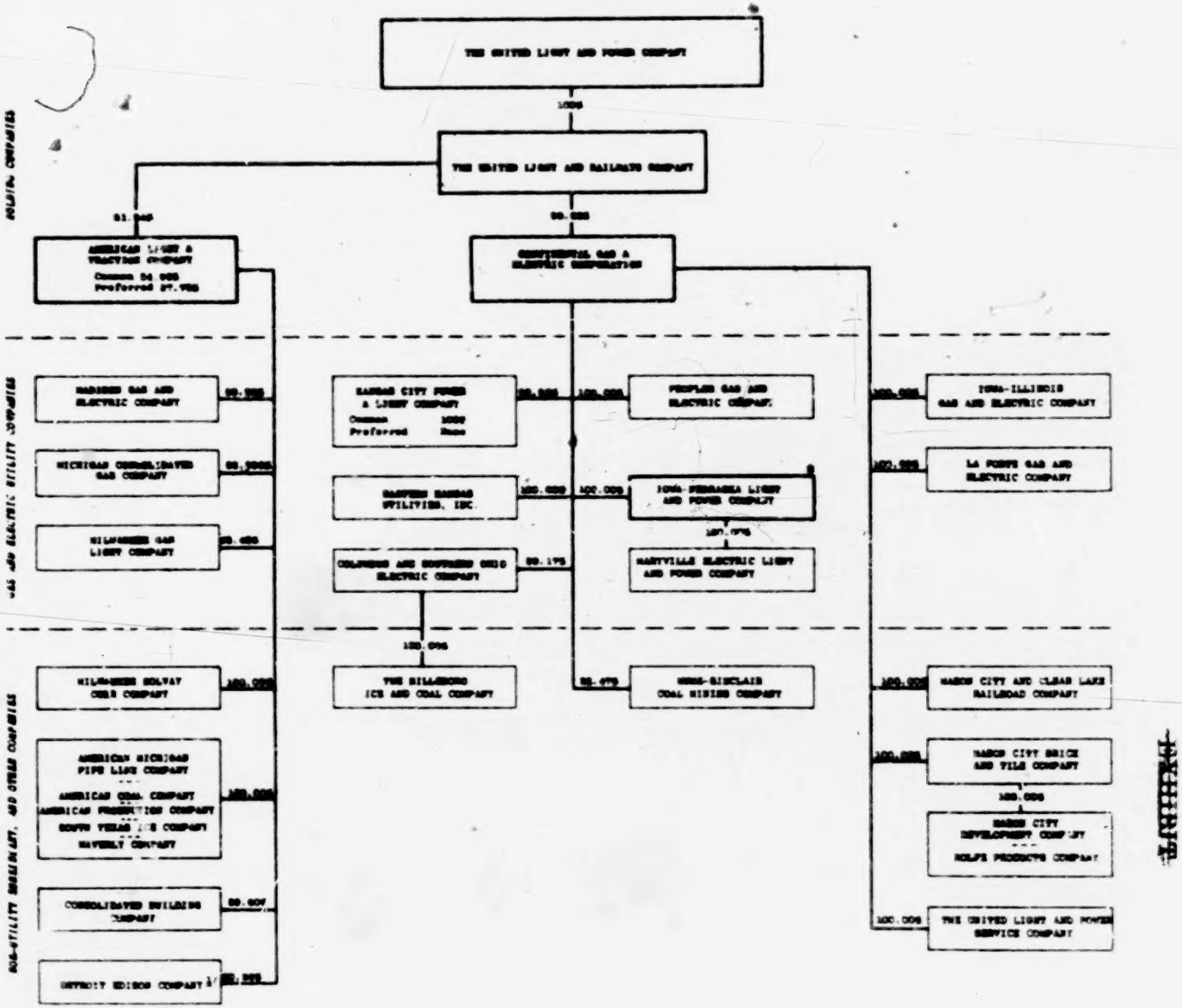
April 1, 1943

(Here follows 1 photolithograph, folio 35-36.)

EXHIBIT A

PRO-FORMA CORPORATE CHART OF POWER AND ALL SUBSIDIARIES
THEREOF SHOWING THE PERCENTAGE OF EACH CLASS OF VOTING
SECURITIES OF EACH SUBSIDIARY HELD BY POWER AND EACH
SUBSIDIARY AND THEREOF

Date: November 1, 1968



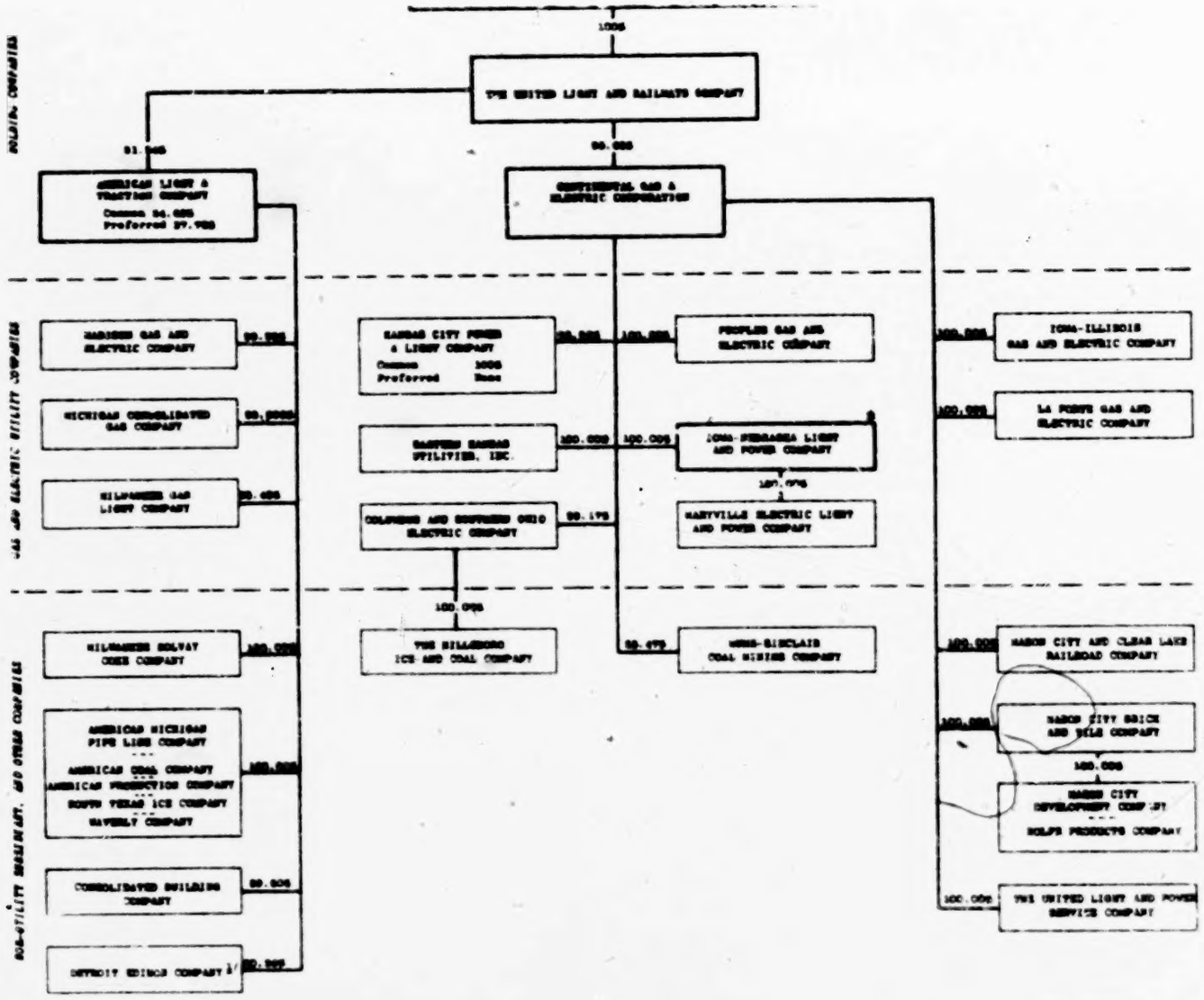


EXHIBIT E

* IOWA-NEBRASKA LIGHT AND POWER COMPANY IS ALSO A HOLDING COMPANY.

NOTE: THE FIGURE SET FORTH IMMEDIATELY ABOVE THE NAME OF EACH SUBSIDIARY COMPANY INDICATES THE PERCENTAGE OF THE TOTAL VOTING POWER CONSTITUTED BY THE SECURITIES OF THE SUBSIDIARY OWNED BY THE DESIGNATED HOLDER OF THE SECURITIES OF THE SUBSIDIARY. IN CLASS WHERE LESS THAN ALL THE VOTING SECURITIES ARE OWNED BY THE DESIGNATED HOLDER AND THE VOTING SECURITIES CONSIST OF MORE THAN ONE CLASS OF SECURITIES, THE PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED BY THE DESIGNATED HOLDER IS SET FORTH WITHIN THE RECTANGLE DESIGNATING THE SUBSIDIARY.

1/ EXEMPT AS SUBSIDIARY BY ORDER OF COMMISSION OF AUGUST 8, 1945.

[fols. 37-38]

EXHIBIT B

The United Light and Railways Company—Actual and Pro Forma Corporate Balance Sheets—With Details of Transactions—April 30, 1942

	Per Books	Contribution of Investment in Clear Lake by Power	Contribution of Remaining Assets by Power	Exchange of Common Stock of Railways	Pro Forma
Assets					
Investments in subsidiaries *b*	$115,747,799	$150,000	—	—	$115,897,799
Other investments	1,372,958	—	—	—	1,372,959
Deferred charges	466,012	—	$60,841	—	526,853
Special deposit in escrow of redemption premium of debentures of Power	—	—	1,358,442	—	1,358,442
Current Assets (cash $2,399,277)	2,321,940	—	433,918	—	2,755,857
Pro Forma					
Total	$119,908,709	$150,000	$1,853,201	—	$121,911,910
Liabilities					
5½% Debentures due 1952	$23,837,000	—	—	—	$23,837,000
7% prior preferred stock, cum.	3,799,300	—	—	—	3,799,309
6.36% prior preferred, cum.	5,232,900	—	—	—	5,232,000
6% prior preferred, cum.	9,951,600	—	—	—	9,951,600
Common stock	24,798,200	—	—	($1,112,138)*c*	23,686,062
Current Liabilities *b*	1,136,236	—	—	—	1,136,236
Paid-in Surplus *d*	47,608,905	$150,000	$1,853,201	1,112,138	50,724,244
Earned Surplus *d*	3,544,568	—	—	—	3,544,568
Total	$119,908,709	$150,000	$1,853,201	$	$121,911,910

a The pro forma balance sheet reflects consummation of the plan in its original form with the issuance of 3,947,677 shares of new $6 par value common stock of Railways.

b The pro forma investment account and current liabilities would be increased by $1,500,000 in the event the sale of La Porte is not consummated before the effective date of the Plan.

Shares		Par Value Per Share	Total
Present	708,520	$35	$24,798,200
Pro Forma	3,947,677	6	23,686,062
		Reduction in common stock	$1,112,138

d See Notes c and d to the consolidated balance sheet (Exhibit C).

[fol. 39] EXHIBIT C

The United Light and Railways Company and Subsidiaries

Actual and Pro Forma Consolidated Balance Sheet—April 30, 1942

Assets	Actual	Pro Forma [a]
Utility Plant (including intangibles)		
Combined property accounts of operating subsidiaries	$391,372,776 [b]	$391,372,776 [b]
Excess of carrying value of investments in securities of subsidiaries over underlying book value at dates of acquisition	38,441,561	38,441,561
	$429,814,337	$429,814,337
Investments		
The Detroit Edison Company	$ 47,361,886	$ 47,361,886
International Paper Company	3,938,091	3,938,091
Miscellaneous (less reserve for loss on miscellaneous investments of $182,250)	4,062,824	4,212,824
	$ 55,362,801	$ 55,512,801
Deferred Charges	$ 21,279,298	$ 21,340,139

[a] Giving effect to the acquisition from Power of assets aggregating $2,003,200, credited to paid-in surplus, the reduction of $1,112,138 in the par value of common stock, also credited to paid-in surplus, and the issuance of 3,947,677 shares of new $6 par value common stock of Railways.

[b] At April 30, 1942 there was included in Utility Plant Account an aggregate of approximately $17,500,000 in Accounts 100.5 and 107. At December 31, 1942, after adjustments by Kansas City in accordance with orders of

Special Deposit in Escrow of redemption premium in connection with payments of debentures of The United Light and Power Company	—	1,358,442
Current Assets	52,351,127	52,785,045
	$558,807,563	$560,810,764
[fol. 40] Liabilities		
Capital Stock of the United Light and Railways Company		
Preferred	$ 18,983,800	$ 18,983,800
Common	24,798,200	23,686,062
	$ 43,782,000	$ 42,669,862

the Federal Power Commission, there remained approximately $14,300,000 in these accounts; $8,500,000 in 100.5 and $5,800,000 in 107. After excluding the portion applicable to minority interests, there is applicable to Railways' common stock approximately $7,360,000 in Account 100.5 and approximately $4,060,000 in Account 107.

Four of the system companies are presently involved in proceedings before Federal or State regulatory authorities to determine the appropriate disposition of the amounts included in these accounts. Applicants estimate that these proceedings will dispose of over 85% of the aggregate amount included in Account 107 and approximately 30% of the aggregate amount included in Account 100.5. The major remaining item in Account 100.5 in the amount of approximately $5,000,000 or 60% of the system aggregate, relates to Columbus and Southern Ohio Electric Company. This company is subject to the jurisdiction of the state utility commission of Ohio but not of the Federal Power Commission. It has not as yet been required to file a study with respect to the original cost of its property nor any plan for the disposition of the amount included in Account 100.5.

Capital Stock of Subsidiaries and Surplus Applicable to Common Stock Held by Public		
Preferred	$ 45,860,693	$ 45,860,693
Common	31,658,002	31,658,002
Paid-in Surplus Applicable to common stock[c]	8,457,991	8,457,991
Surplus applicable to common stock[c]	13,557,353	13,557,353
	$ 99,534,039	$ 99,534,039
Long-Term Debt		
The United Light and Railways Company	$ 23,837,000	$ 23,837,000
Subsidiaries	207,823,500	207,823,500
	$231,660,500	$231,660,500
Due to Affiliated Companies	8,884	8,884
Current Liabilities	33,059,094	33,059,094
Premium on Long-Term Debt, less expenses, in process of amortization over lines of related issues	4,798,508	4,798,508

[c] The validity of the aggregate amount in the two surplus accounts is subject to such adjustments as may be necessary to evaluate properly the following items: (a) excess of carrying value of investments in securities of subsidiaries over underlying book value at date of acquisition in the amount of $38,441,561; (b) amounts classified as Account 107 in the amount of $8,979,909 and Account 100.5 in the amount of $8,614,101; and (c) the excess of the carrying value of the investments in Detroit Edison and International Paper Company over the company's estimate of the value thereof, which value is approximately $15,000,000 less than the amount presently recorded on the books.

[fol. 41]

Reserves		
Depreciation	$ 85,525,628	$ 85,525,628
Other	3,195,614	3,195,614
	$ 88,721,242	$ 88,721,242
Contributions in Aid of Construction	$ 2,490,367	$ 2,490,367
Paid-in Surplus [c]	47,608,905 [d]	50,724,244 [d]
Surplus—Applicable to the United Light and Railway Company [c]	7,144,024	7,144,024
	$558,807,563	$560,810,764

[fol. 42] BURKE, C., concurring:

I agree with all that is said in the principal opinion. I desire merely to point out that, for my part, the rejection of the proposed allocation of 8.8% of the common stock of Railways to the holders of the common stock of Power need not be rested solely upon an over-all judgment.

As stated in the principal opinion, the valuation of interests such as these is not an exact science, even in the most favorable circumstances. Presented with a proposed

---

[c] The validity of the aggregate amount in the two surplus accounts is subject to such adjustments as may be necessary to evaluate properly the following items: (a) excess of carrying value of investments in securities of subsidiaries over underlying book value at date of acquisition in the amount of $38,441,561; (b) amounts classified as Account 107 in the amount of $8,979,909 and Account 100.5 in the amount of $8,614,101; and (c) the excess of the carrying value of the investments in Detroit Edison and International Paper Company over the company's estimate of the value thereof, which value is approximately $15,000,000 less than the amount presently recorded on the books.

[d] Of this amount $46,053,800 arose from the reduction in 1932 of the par value of common stock from $100 to $35 per share.

allocation of assets such as that suggested here, the best we can do is to determine what assumptions are necessary to arrive at the allocation, and ascertain whether such assumptions fall within the permissible limits of reasonableness. It is obviously impossible to estimate future earnings or determine the proper basis of appraisal of interests therein with sufficient exactness to arrive at a precise mathematical allocation. But the mere fact that a particular method of appraisal lacks the degree of precision which might be desired does not justify rejecting its use where that degree of precision is not called for. It is possible to determine, in the light of various possible assumptions as to earnings and as to the basis of appraisal of interests therein, whether the common stock is entitled to some recognition, and whether the proposed 8.8% allocation to the Power common stock falls within or without the permissible limits of reasonableness. An ordinary yardstick may be of little use in measuring sixty-fourths of an inch, but it is a convenient instrument where there are yards, or even inches, to be measured.

I turn then to a consideration of the reasonableness of the proposed allocation—91.2% to the preferred stock and 8.8% to the common stock of Power.

If Power's existing capital structure were retained, the preferred would have a claim on earnings, prior to that of the common stock, for its annual dividend requirements of $3,600,000. The balance of earnings, or so much thereof as [fol. 43] was available to the parent company for the payment of dividends, would be applicable first to the elimination of the $38,700,000 of preferred arrearages, and thereafter to the common stock. If net earnings of the system were to average $6,185,000, a figure which the principal opinion characterizes as "a very liberal assumption as to earning power", the arrearages could be paid off in approximately 15 years, if the entire amount of earnings were available to Power and were paid out in dividends. I start with liberal assumptions as to earnings since if 8.8% appears excessive under such assumptions, it clearly could not be justified if more conservative hypotheses were used.

A prior claim of $3,600,000 on consolidated net income of $6,185,000 is obviously to be valued on a different basis from the claim to the balance of such consolidated net income, to whomsoever the latter claim belongs. These facts

appear to me to furnish a possible basis for testing the fairness of the proposed allocation as between the preferred and common stockholders of Power, believing as the majority does that the amount of the liquidation preference of the preferred stock is not controlling, but that, as stated in the principal opinion, the proposed allocation is to be judged "according to the legitimate investment values existing apart from the duty of liquidation imposed by the statute."

If a rate as low as 5% were used in capitalizing the earnings applicable to the preferred's prior claim of $3,600,000 for current dividends, it would be necessary to apply a rate of 8.5% (equivalent to nearly 12 times earnings) to the remainder of the estimated earnings of $6,185,000 in order to arrive at an allocation to the Power common of as much as 8.8%.[1] Both of these rates are obviously much too low in a situation of this kind. If the capitalization rate applicable to the preferred's prior claim for current dividend [fol. 44] were increased above 5%, however, the 8.8% allocation could be arrived at only by narrowing the spread between the rates to a point clearly inappropriate here, where the requirements for current preferred dividends equal 58% of the net income. For example, if an 8% capitalization rate were used for the preferred cur-ent dividends, the rate for the balance would have to be 10%. It is clear that if an 8% rate were appropriate for the former, a rate substantially higher than 10% should be used for the residual earnings. I therefore conclude that the assumptions necessary to arrive at an allocation as large as that suggested in the plan are clearly unreasonable even if all doubts are resolved in favor of the common.

Since the only proposal now before us provides for an allocation of 8.8% of the common stock of Railways to the common stockholders of Power, our inquiry might well have been terminated at this point. However, in order that the management may be provided with some guidance in formulating an amendment to the plan, if they desire to do

---

[1] The present value of the earnings applicable to the common stock after provision for the preferred arrearages would be arrived at by capitalizing them and then discounting the resulting value to present worth, thus giving effect to the fact that there would be no earnings applicable to the common until after the arrearages had been paid off.

so, I believe it is appropriate for us to consider the participation, if any, which we could approve for the common stock.

After a careful appraisal of the contingencies involved, I agree that the common does have a prospect of sharing in the future earnings of the enterprise and is therefore entitled to some participation.

An allocation of approximately the 5% suggested in the principal opinion would appear to be very generous, even on the basis of liberal assumptions as to earnings, if tested by the method just applied to the proposed allocation of 8.8%. However, the margin of error involved in calculation of this type assumes greater importance as the participation approaches the vanishing point, and intangible considerations become entitled to increased weight. It must be borne in mind that an appraisal of the earning power, under normal conditions, of the system as now constituted must necessarily result not in a single figure, but an esti- [fol. 45] mated range—a maximum and a minimum. Earnings actually realized in a particular year, and indeed the average earnings actually realized over a period of time, might well be above or below the mean between this maximum and minimum. *Earnings actually realized in a particular year, and indeed the average earnings realized over a period of time, might well be above or below the mean between this maximum and minimum.* Should earnings exceed the estimate the common would receive only a small part of the increase although in the absence of a recapitalization they would be entitled to all earnings in excess of current preferred dividends, after settlement of the arrears. On the other hand since the common is to receive only a small percentage of the entire equity, the extent to which the preferred would suffer thereby if the earnings fall below the estimate on which the allocation is made would be negligible.

On the basis of a 95%—5% split and projected earnings of $6,185,000, 95% of that amount or $5,875,750 would be allocable to the preferred in perpetuity, instead of the $3,600,000 dividends to which they would be limited, after settlement of the arrears, if the present capital structure were preserved. In addition, 95% of any excess over such projected earnings would go to the preferred stock.

Under these circumstances, as the participation of the common approaches zero, we are warranted in considering increasingly liberal assumption in favor of the possibility

that earnings may substantially exceed what may be characterized as "reasonably foreseeable." In other words, the possible (though unlikely) rather than the probable range of earnings may be taken into account for the purpose of allotting to the common stockholders a small participation—whereas allotment of a more substantial participation would necessitate a more conservative appraisal. In view of these considerations I am unable to say that an allocation around 5% would be unfair.

April 1, 1943.

[fol. 46] DISSENTING OPINION

HEALY, C., dissenting:

This plan provides for the liquidation of Power through the disposition of its assets and its subsequent dissolution. It is filed under Section 11 (e) of the Act. It is not to be submitted to the stockholders. If approved by us, we are to apply to a court to enforce it, i. e., to impose it on the stockholders. Under 11 (e) we cannot approve the plan unless we find it necessary to effectuate the purpose of 11 (b) of the Act and fair and equitable to the persons affected by it.

I

Is the plan fair and equitable to the persons affected by it? Among those affected by it are the preferred stockholders. I think the plan is unfair and inequitable as to them. Whether it is fair and equitable as to them depends on their contract rights. These are found in the corporation's charter, which provides—

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned), including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock. Any assets thereafter remaining shall be dis-

tributable among holders of stock other than the Class A Preferred stock in accordance with their rights at the time of the distribution."[1]

[fol. 47] A liquidation and dissolution of Power is taking place.[2] The argument that by some strange legal alchemy the disposition of the assets of Power and its enforced dissolution is not really a liquidation at all falls in face of the facts, one of the more important of which is that when the preferred stock was issued and sold to the public, then as now the principal asset of Power was the common stock of Railways. When the incorporators wrote the charter fixing the rights of stockholders upon involuntary dissolution, plainly they were talking about the rights of Power's stockholders to its holdings of Railways' securities.

In my opinion, insisting that the stockholders observe the terms of their contracts is not the application of a bankruptcy technique. It is clear that the preferred stockholders are not receiving that to which the contract entitles them. Involuntary dissolution and liquidation are taking place. The preferred is thereupon entitled to receive from the net assets, whether capital or surplus,[3] for each share of stock,

---

[1] The amended charter (1929) also contains the following:

"The Common Stock of the Company shall be subject to the rights of the holders of the Class A Preferred stock."

[2] This Commission's order of March 20, 1941, pursuant to which this plan was submitted (and certain previous disposition of Power's assets undertaken), provided that Power "shall be liquidated and dissolved." Holding Company Act Release No. 2636. The Second Circuit Court of Appeals, in reviewing this Commission's order permitting the retirement of Power's publicly held debentures without payment of a premium (undertaken in order to comply with our order of March 20, 1941), regarded the retirement of debentures as one step in "the liquidation and dissolution of Power." *New York Trust Co. v. Securities and Exchange Commission*, 131 F. (2d) 274 (C. C. A. 2nd, 1942).

[3] In case of liquidation or dissolution arrearages on preferred stock, where the charter contains such provisions, must be paid before any payment is made to the common even if the use of capital is thereby necessitated. See *Willson v. Laconia Car Co.*, 176 N. E. 182 (Mass. 1931); *Cox v.*

$100 plus arrearages $64.50 (to December 31, 1942) or $164.50, or for 600,000 shares a total of $98,700,000 before any payment in money or kind is made to the common stock. I agree that the preferred stockholders are not entitled to [fol. 48] be paid in cash in the present circumstances. I agree it is appropriate to pay them in kind. In this case they are being paid with common shares of Railways. It is agreed by the majority that the Railways common to be paid them, or indeed all of it including what is not being delivered to them, is not worth $98,700,000, or anywhere near it, either on an asset basis or any reasonable capitalization of foreseeable earnings or indeed on any basis. Yet the Power common is getting 5.48% or 173,838 shares of Railways common with a par value of $1,216,866 and a consolidated book value of about $4,450,000 before the charter provision as to the preferred has been honored. I regard this as a breach of the contract. I think it flagrantly disregards the rights of the preferred stockholders.[3a] The Circuit Court of Appeals for the Second Circuit in the course of dealing with one stage of this very dissolution of this company, in denying the right of the bondholders to be paid a premium said:

> "The order under review [i. e., the S. E. C. order of February 25, 1942] was, accordingly, fair and reason-

Sellers, 28 A. (2d) 679 (Del. 1942). The right to accrued dividends is treated as a "vested right." See the *Laconia Car* case; *Morris v. American Public Utilities Co.*, 122 Atl. 696 (Del. 1923); *Pennington v. Commonwealth Holding Const. Corporation*, 155 Atl. 514 (Del. 1931); *Consolidated Film Industries v. Johnson*, 197 Atl. 489 (Del. 1937); *Roberts v. Roberts-Wicks Co.*, 77 N. E. 13 (N. Y. 1906). [Cf. *Davison v. Parke, Austin & Lipscomb, Inc.*, 35 N. E. (2d) 618 (N. Y. 1941) which, while throwing doubt on the constitutional implications of the "vested rights" principle enunciated in earlier New York cases, asserted that the legislature had not intended in the instance to allow preferred stockholders to be deprived of their charter right to accrued dividends.]

[3a] In the majority opinion in the Federal Water Service case (—S. E. C. p.—) there was a concession that, had the case involved a liquidation, the opinion would have had a different result. This dictum is now rejected in the majority opinion.

able to all parties in interest since it provided for the payment of the bonds *in a way which discharged in full the contract obligations of the dissolved corporation.*" See *New York Trust Co. v. Securities and Exchange Commission*, 131 F. (2d) 274. (Emphasis supplied.)

So now the plan of dissolution and the order approving it are not fair and equitable to all parties in interest since it does not provide for a treatment of the preferred in a way which conforms to the charter. When this Commission issued its orders in the bond premium cases, one involving Power and the other North American Light & Power, it rested its decisions squarely upon the contract provisions [fol. 49] as to the rights of bondholders upon involuntary dissolution. When the Circuit Court of Appeals for the Seventh Circuit affirmed our order in the North American Light & Power case (on March 5, 1943) it said that the petitioners who were seeking a premium on debentures must stand or fall on the issue as to whether North American Light & Power was required by contract to pay a premium on redemption under the circumstances with which it was confronted. The Court said the principal question presented was whether the debenture holders had a contract right to the payment of a premium upon redemption of the debentures occasioned by the involuntary act of Light & Power. The Court answered this question in the negative. Plainly it based its decision, as we based ours, upon the specification in the contract as to how the debentures should be treated in involuntary dissolution. See *City National Bank and Trust Company v. Securities and Exchange Commission*, — F. (2d) — (C. C. A. 7th, 1943). I rest this dissent upon the contract provision as to the rights of the preferred upon involuntary dissolution.

The majority opinion rejects this view on several grounds.

It says that dissolution under this Act was not foreseen and was not in the minds of the incorporators when the charter was written. I agree. However, what was in their minds, what was foreseen and provided for, was that there might be dissolutions from unforeseeable and unpreventable causes. The parties in the charter fixed their rights of participation in case of voluntary or involuntary dissolution of Power. They made possible also redemp-

tion of the preferred stock. As redemption would be within the control of the company, it was recognized that it would be unfair to redeem the preferred at ordinary liquidation value in view of the fact that it had accepted a limited return on its investment. In event of redemption, therefore, the preferred was to receive an additional premium of $5.00 per share. No premium was provided in case of in- [fol. 50] voluntary dissolution, in view of the fact that this would be beyond the control of all classes of stock.

With knowledge of the possibility of enforced liquidation and dissolution in mind, the incorporators provided that, in case of involuntary liquidation, the preferred must receive $100 per share and arrearages before the common got anything. The common thereby assumed the risk that if, through no fault of either class of stockholders, the company should be required to go out of existence because of unforeseen circumstances, the preferred would be paid its full liquidating value (including arrearages), which might leave the common nothing. The common's right was to unlimited participation in assets not subject to superior claims.

The charter made provision for the rights of stockholders upon dissolution or liquidation of the corporation, whether voluntary or involuntary. When provision is made for distribution rights upon either voluntary or involuntary dissolution, provision is made for every possible kind of dissolution.

What was meant to be covered by involuntary liquidation except the unpredictable and the unpreventable? It need not be just insolvency or money troubles. It might be a dissolution action under the Sherman Act, the Clayton Act, the Hepburn Act, a *quo warranto* by the state attorney general, or any action that a superior authority might compel. The authority which forces involuntary dissolution is usually that of the government.[4]

The resemblance of proceedings under Section 11 (b) to proceedings under the Sherman Act and the Hepburn Act was pointed out by the committee reporting this bill

[4] Under most state laws a charter is accepted, generally speaking, subject to the right of the state to terminate it. See Note: Power of State to Alter Corporate Charters, 31 Col. L. Rev. 1163 (1931).

to the Senate. Footnote 16 of the majority opinion calls attention to that report. The Senate report, as footnote 17 of the majority opinion points out, in connection with Section 11 (b), speaks of the courts exercising all the extraor- [fol. 51] dinary powers such courts have been accustomed to exercise when called upon under the Sherman and Hepburn Acts to effect compulsory corporate readjustments required by the public policy expressed in those Acts. There were other similar references which need not be repeated. It therefore appears that Congress in enacting Section 11 had definitely in mind precedents under the Sherman Act and the Hepburn Act.

An examination of cases which arose under those Acts and which were decided by the Supreme Court before 1935 discloses that, instead of sustaining the position of the majority, the opposite view is found to be sustained. In the hearings before Congress probably no precedent of the courts was so often cited as the decision of the Supreme Court in the *Reading* case.[5] The Reading Company was required, as a combination in violation of the Sherman and Hepburn Acts,[6] to confine itself to ownership and operation of a railroad system, and to dispose, *inter alia*, of its interest in a coal business. In *United States v. Reading Co.*, (273 Fed. 848, (D. C. E. D. Pa., 1921)), the District Court, upon the mandate of the Supreme Court in 253 U. S. 26, approved a plan for the liquidation and dissolution of Reading, and provided for distribution in kind of the surplus of Reading to its preferred and common stockholders, who were to receive, share and share alike, assignable certificates of interest in the stock of the new company formed to take over Reading's coal business. Common stockholders of Reading contended that *under the charter* of Reading, the distribution of its surplus should go to common stockholders only, and this question came before the Supreme Court. *Continental Ins. Co. v. United States*, 259 U. S. 156 (1922).

The preferred and common stock of Reading consisted of an equal number of voting shares at $50 par value. The

---

[5] See e. g. remarks of Senator Wheeler, 79 Cong. Rec. 4605-4607, 8432 (1935); Mr. Eicher, 79 Cong. Rec. 10361-2 (1935).

[6] *U. S. v. Reading Co.*, (1920) 253 U. S. 26.

[fol. 52] preferred was entitled to 4 percent non-cumulative dividends and was subject to redemption at par (in cash), (259 U. S. 156, at 179). The charter did not give the preferred stock any preference upon liquidation or distribution.

The contention of the common stockholders that they were entitled to the surplus of Reading to the exclusion of preferred stockholders was dismissed by the Supreme Court upon its interpretation of the Reading charter (259 U. S. 156, at 177-181). At page 181, the Court said that "stockholders, common and preferred, share alike in the assets of a liquidating corporation, if the preference *is only as to dividends.*" [citing cases] (emphasis supplied).

Starting with the Supreme Court's premise that in a liquidation and dissolution compelled by federal law the rights of preferred and common stockholders *inter sese* are to be determined *by their contract*,[7] the conclusion is inescapable that preferred stockholders who are entitled to liquidation preferences must be paid such preferences in full before common stockholders are permitted to participate. A statement made by the management of Reading in connection with an application to the New York Stock Exchange for stock listing, that "the preferred and common stock * * * in liquidation or dissolution of the corporation, will share equally in pro rata distribution of assets" was regarded by the Supreme Court as shedding light on "the kind of interests they were buying in the company" (259 U. S. 156, at 180-181). It was considered by the Supreme Court in determining the participation in the Reading liquidation under the anti-trust laws.[8] *A for-*

[7] See also *Standard Oil Co. v. United States*, 221 U. S. 1 (1911), and *United States v. American Tobacco Co.*, 221 U. S. 106 (1911), as to the determination of the Supreme Court to effect dissolution in accordance with the contract rights of the security holders. This was emphasized in another part of the *Continental Co.* case in 259 U. S., in which provision was made to protect mortgage bondholders whose mortgage covered the property of both Reading and the coal company prior to the dissolution. See 259 U. S. 156, at pp. 167-174.

[8] I must confess to a feeling that the charter provisions themselves are of greater weight than representations in

[fol. 53] *fiori*, a charter provision, as here, expressly granting to preferred stockholders a preference to the extent of $100 a share plus accumulated dividend arrearages "upon the dissolution or liquidation of the corporation, whether voluntary or involuntary" must be respected by us, and the liquidating preferences and arrearages paid to the preferred before the common can participate.

The *Reading* case (and the *American Tobacco* case) convince me that rights among stockholders are to be determined according to their contracts when involuntary dissolution is forced by a federal statute.

Because United has assets insufficiently to satisfy in full the liquidating preference of its preferred stockholders, I consider it not fair and equitable to permit its common stockholders to participate in such assets as are available for distribution.

Any intimation that this is the equivalent of the destruction of investment values is unwarranted. Both the majority and I are in complete accord that the value of these assets is substantially less than the liquidating value of the preferred including arrearages. I am also in complete accord with the majority that the elimination of unnecessary companies and simplification of structures do not destroy values but do destroy needless expenses and so improve the investment values of the securities involved.

II

In my view, as expressed heretofore, the action to be taken by Power will constitute liquidation and dissolution within the meaning of its charter. So my dissent rests on the fact that the preferreds' liquidation preferences and arrearages are not protected in the order of the Commission. If, however, the disposition of the assets of Power and its subsequent dissolution must be treated not as a liquidation and [fol. 54] dissolution within the meaning of its charter but

---

listing applications. Nevertheless, I point out what appears in a certified copy of the application made by Power for listing its preferred stock on the Chicago Stock Exchange. Item N in the ap-lication reads: "Preference or other rights upon distribution of assets". The sworn answer is: "Preference over all other stocks of company in liquidation."

as a reorganization or recapitalization, then I regard the treatment of the preferred as not fair and equitable. My views on this matter have been expressed in my dissents in the *International Paper and Power Company* case, 2 S. E. C. 274 at 285 ff. (1937), and the *Federal Water Service Corporation* case, 8 S. E. C. 893, at 921 ff. (1941).

I regard the question, "Is the plan fair and equitable?" as one of law. I do not regard it as a matter of administrative grace or the uncontrolled discretion of the Commission. Undoubtedly, it involves the exercise of judgment by the Commission but its correct decision should rest upon, or at least be consonant with principles of law and contract established by the courts. If the words "fair and equitable" mean whatever we say they mean, if their meaning is not a matter of law, then my conclusion, based on my observation and experience as a Commissioner, and on my views as to the Act itself, is that "fair and equitable" ought to mean that in reorganizations under this Act as elsewhere the principle of absolute priorities prevails.[9] A decent regard for the rights of security holders under financial contracts leads me to no different result. The absolute priority doctrine

---

[9] For my part I prefer that our conclusions as to the meaning of words in our statutes be treated as matters of law subject to court review, and that our conclusions be given great weight by the courts in arriving at their own conclusions because of our experience and duties under those statutes. Such was the established view of the Supreme Court for many years following its decision in *Federal Trade Commission v. Gratz*, 253 U. S. 421 (1920). (Cf. *Standard Oil Co. of N. Y. v. Federal Trade Commission*, 273 Fed. 478 (C. C. A. 2, 1921 where the holding of the *Gratz* case was applied in the following language at p. 481: "Whatever may be the exact meaning or extreme scope of the still novel phrase 'unfair method of competition', it is settled that it is for the courts and not the Commission to determine as matter of law what is and what is not included in the phrase.") If such is not the rule I cannot see that the doctrine of the supremacy of law in America is in force. It seems to me the supporters of a contrary view (and this does not include any of my brother Commissioners) are merely passing the ammunition to those who oppose the administrative process.

is not a variation from normal law. It is not in law what a sport is in biology. It rests on the superior position which a creditor holds as against stockholders, which the stockholder with full preferences as to assets and earnings holds [fol. 55] as against the common stockholder. Whenever those superior rights are threatened with mistreatment, whether through conveyances in fraud of their rights, or waste, or allocation of securities in reorganization, or the distribution of assets in liquidation, the law recognizes and protects that superiority of position.

My views proceed from the same basic premises which caused me to dissent in the *Federal Water Service Corp.* case (8 S. E. C. 893). I shall repeat those premises without repeating the arguments or citations I included in that dissent, except to the extent that new arguments contrary to my views appear in the opinion herein.

The first premise is that the expression "fair and equitable" found in Sections 11 (c) and 11 (d) is a term of art having a settled meaning, requiring the application of the principle of absolute priorities to the reorganization of corporations.[10] The Supreme Court has repeatedly held that where language used in a statute had acquired a settled meaning in court decisions, Congress will be presumed to have used the language to convey that meaning. That is what the Court held in the *Los Angeles Lumber* case when it passed on the words "fair and equitable," which in 1934 had been lifted out of the equity receivership cases and transferred to Section 77(b) of the Bankruptcy Act.[11] The phrase "fair and equitable" had a settled meaning when Congress used it in 77 (b) in 1934. It still had it when Congress used it again a year later in 1935 in the Holding

[10] Compare *Group of Institutional Investors and Mutual Savings Bank Group v. Chicago, Milwaukee, St. P. & Pac. R. R. Co.*, Nos. 11-19, 32, and *Ecker v. Western Pacific Railroad Corp.*, Nos. 7, 8, 20, 33 and 61, decided by the Supreme Court March 15, 1943, — U. S. —.

[11] This Commission took the same position as to the term "trade secret" in Section 24 (a) of the Securities Exchange Act of 1934 in its brief in the *Sumatra Tobacco Company* case and was sustained therein by the Court of Appeals for the District of Columbia. See *American Sumatra Tobacco Corporation v. Securities and Exchange Commission*, 93 F. (2d) 236 (1937).

Company Act, an Act which Congress knew would inevitably involve liquidations and reorganizations. The settled meaning connoted the absolute priorities doctrine.

[Vol. 56] The second premise is that the settled meaning of "fair and equitable" described in my first premise applies to the reorganization of solvent corporations.[12]

The third premise is that the absolute priority rule applies as between classes of stockholders.[13]

These three premises add up to the conclusion that in this reorganization the common stock can participate only if (1) the preferred stock is completely compensated for all it surrenders, i. e., its prior claim on earnings, its prior claim on assets in case of liquidation, and its claim to ac-

---

[12] *Du Bois v. Consolidated Rock Products Co., Inc.*, 312 U. S. 519 (1941).

[13] This premise rests on a number of lower federal court cases cited in Footnote 13 of my opinion in the *Federal Water Service* case. The precise question, so far as I am aware, has not been passed on by the Supreme Court, although it has been approved by implication in *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307 (1939) where the court did not find unfair that aspect of the plan before it which granted participation to the old preferred while denying it to the old common. The Supreme Court in the *Los Angeles Lumber* case has also cited several cases so holding: *Flershem v. National Radiator Corporation*, 64 F. (2d) 847 (C. C. A. 3, 1933) (rev'd for reasons not relevant here, 290 U. S. 504 (1934)); *In re New York Railways*, 82 F. (2d) 739 (C. C. A. 2, 1936) cert. den. 298 U. S. 687; *In re Day & Meyer, Murray & Young*, 93 F. (2d) 657 (C. C. A. 2, 1938). See also *In re Consolidation Coal Co.*, 11 F. Supp. 594 (1935); *In re Oscar Nebel Company, Inc.*, 115 F. (2d) 141 (C. C. A. 3, 1940). In its brief in the last case, this Commission expressly took the position that the absolute priorities doctrine applies between classes of stockholders. Apparently Judge Jerome Frank, now of the Circuit Court of Appeals for the Second Circuit and formerly Chairman of this Commission, whose views greatly influenced the majority opinion of this Commission in the *Federal Water Service* case, took a contrary view some years ago. See: Frank, Some Realistic Reflections on Some Aspects of Corporate Re-Organization, 19 Va. L. Rev. 541 (1932).

cumulated arrearges and (2) there is a value remaining for the common after these rights have been fully compensated. I cannot find that there is a value remaining for the common in this case.

III

I now turn to the questions: (1) Does the plan fully compensate the preferred for all it surrenders? (2) Is there a value remaining for the common after the preferred's rights have been fully compensated?[14]

I recognize fully that in valuing enterprises either in liquidation or for reorganization purposes rigid formulae [fol. 57] should not be insisted upon. I recognize also that forecasts of earnings cannot be exact and at best are no more than estimates. With the principle, however, that the absolute priorities doctrine applies as between the preferred stock and the common, and that this right of the preferred is to be measured by its liquidating value, including its arrearages and its claim on earnings, I am unwilling to consider any compromise.

The Asset Basis

I consider these questions first on an asset basis. I agree with the opinion that this basis is not conclusive. It is important, however, because of its bearing on earnings and for other reasons. The subsidiaries from which earnings originate are, for the most part, operating public utility companies. Their rates may be assumed to be made on rate bases derived from either original cost, prudent investment, present value, or a combination of them. In rate making, where present value is used, values are used in the determination of earnings; earnings are not used to determine values.

The opinion states that "The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942."

At April 30, 1942, the balance sheet of Power[15] carried

[14] This is on the assumption which I cannot accept that we are dealing with some kind of reorganization and not a liquidation.

[15] A condensed balance sheet of Power at April 30, 1942 is given in the opinion.

the preferred stock at $60,000,000, and the common stock at $13,907,072. There was a deficit in earned surplus of $1,843,832. If the preferred's dividend arrearages of $36,300,000 at that date were taken into account, the deficit would be increased to $38,143,832 and the common stock would be wiped out; in fact, it would be $24,236,760 "underwater". In other words, net assets would be $24,236,760 less than enough to satisfy the liquidation preference of Power's preferred including its arrearages.

[fol. 58] The principal asset of Power is the common stock of Railways. At April 30, 1942 the book value applicable to Railways' common stock was $77,954,874 on a corporate basis and $81,554,330 on a consolidated basis. Both figures are *pro forma*, after giving effect to contributions by Power of certain assets.[16] On this basis, the liquidation preference of Power's preferred, including arrearages of $36,300,000, exceeds the book value of Railways' common by $18,345,126 on a corporate basis, or $14,745,670 on a consolidated basis. In other words, even if the preferred stockholders were given all of Railways' common stock, they would still not receive anything equal to the face amount of their present claim.[17]

However, the net asset figures of $77,954,874 and $81,554,330 representing the book value of Railways' common stock, are open to challenge. Moreover, they are reached only after deducting very substantial amounts of senior security claims.

At April 30, 1942 Railways' consolidated balance sheet showed net assets applicable to outstanding securities of $431,732,669. Claims senior to Railways' common stock aggregated $350,178,339. The balance of $81,554,330, only

---

[16] *Pro forma* corporate and consolidated balance sheets of Railways at April 30, 1942, are given in exhibits to the opinion.

[17] As Justice Douglas pointed out in the *Chicago, Milwaukee, St. Paul & Pacific R. R. Co.* case, — U. S. —, "The second of these objections is that General Mortgage bonds are to receive under the plan only a face amount of inferior securities equal to the face amount of their claims. The objection would, of course, not be valid if claimants wholly junior to the General Mortgage bonds were not participating in the plan. * * *"

about one-fifth of the total, is all that remains for Railways' common stock. This amount may be broken down into its principal components as follows:

[fol. 59]

TABLE I

Pro Forma Consolidated
Net Assets at April 30, 1942

Utility Plant (including intangibles)	
Combined property accounts of subsidiaries	$391,372,776
Excess of carrying value of investments in securities of subsidiaries over underlying book value at dates of acquisition	38,441,561
	$429,814,337
Reserve for depreciation	85,525,628
	$344,288,709
Investments (net)	55,512,801
Other assets (net)	15,389,528
Deferred charges (net)	16,541,631
	$431,732,669
Claims of senior securities	350,178,339
Balance applicable to Railways' common stock [18]	$ 81,554,330

[18] These balance sheets give effect to the proposed contribution to Railways of Power's net assets except La Porte Gas and Electric Company and, of course, the common stock of Railways. As to La Porte, the opinion indicates that if it is not sold within the time scheduled for liquidation of Power it will be transferred to Railways and appropriate arrangements made to provide for Power's bank loan, miscellaneous debts and the expense of liquidation. A note to the *pro forma* corporate balance sheet of Railways (which excludes La Porte) merely states that if it were not sold "the *pro forma* investment account and current liabilities would be increased by $1,500,000." It seems very clear to me that the value and probable proceeds from

[fol. 60] The consolidated net assets of $81,554,330 ($77,954,874 on a corporate basis) as shown in Table I are, however, subject to substantial reductions. Shown as part of utility plant is $38,441,561 described as the "Excess of carrying value of investments in securities of subsidiaries over underlying book value at dates of acquisition." This is in addition to the amounts which are included directly in the 100.5 and 107 accounts of the operating companies. It arises in consolidation because the underlying book values of the subsidiaries at dates of acquisition are that much less than the amounts at which the investments representing such underlying book values are carried by the respective holding and sub-holding companies. The balance sheets attached as exhibits to the opinion do not show the basis on which investments are carried and the description of this excess contained in such balance sheets does not call

---

the sale of La Porte exceed the $1,500,000 of bank loans. The other net assets of Power, which are being contributed to Railways, consist of the following:

Special escrow deposit *	$1,358,442
Investments in Mason City and Clear Lake R. R. Co.	150,000
Deferred Charges	60,841
Current Assets	433,918
	$2,003,201

* Assuming that the order of this Commission, affirmed in *The New York Trust Co.* case, is not overruled. See opinion note 15 and related text.

This aspect of the liquidation of Power, although not at all emphasized in the opinion, is important because at present the Power preferred stock has a direct and prior claim on Power's assets in excess of its liabilities.

The point is that under the proposed plan, the preferred loses completely its direct and prior rights in these assets and is given only 95% of the Railways' common stock. Since it is being given common stock, its rights become subordinated to $23,837,000 of Railways' debentures, $18,983,800 of preferred stock and more than $1,100,000 of current debt.

it "Excess of cost of investments * * *," it refers to it as "Excess of carrying value of investments * * *." If it represented actual excess *cost* I believe it would be so described.

In any event, the amount is open to question, since it is a well known fact that many holding companies in the past paid exorbitant prices for the controlling stock of op- [fol. 61] erating companies. To what extent this excess if supported or not supported by values is not explained and I am unwilling to accept it without knowing. Any necessary downward adjustment would further decrease the amount of net assets applicable to Railway's common stock.

Investments are shown at $55,512,801. The investments in The Detroit Edison Company and in International Paper Company are carried at an amount about $15,000,000 in excess of the amount which Power's management estimates they are worth, as indicated in note e to the pro forma consolidated balance sheet of Railways at April 30, 1942 given in Exhibit C of the opinion. In Power's annual report for 1942, however, the accountant's certificate indicates that the carrying value of the investment in The Detroit Edison Company exceeded quoted market value at December 31, 1942 by $25,123,100. Clearly the amount of $81,554,000 should be adjusted downward for the substantial portion (over 50%) of the decline in the value of these investments which is not assignable to the minority interest.[19]

At April 30, 1942 utility plant, including intangibles, contained an amount of $8,979,909 classified in Account 107, where pure write-up representing no investment in the property is carried. While this amount should be elim-

---

[19] The investment in the common stock of International Paper Company, carried at $3,788,569, was sold in December of 1942 for $458,828—a loss actually realized of $3,329,741. At December 31, 1942, the quoted market value of the investment in 1,289,205 shares of common stock of The Detroit Edison Company was $25,123,100 less than its carrying value of about $36¾ per share. This difference is computed on the basis of a quoted market price of 17¼. The high for 1943 is 19½, the low 16⅞ and the close on March 31, 1943, 18½.

inated from the accounts, it is not determinable at this time how much may be charged against the depreciation reserve and how much will be charged against the minority interest. Since April 30, 1942, the amount of $8,979,909 has been reduced to about $5,800,000 partly as a result of a write-off (in large part against the depreciation reserve) made by Kansas City Power and Light Company pursuant [fol. 62] to an order of the Federal Power Commission. Utility plant also includes over $8,600,000 classified in Account 100.5 the account designed to include the excess of cost over original cost. It is true that part of the $8,600,000 is chargeable against the minority interest and some portion of it may be disposed of by a charge against the depreciation reserve. Nevertheless, the provisions of the classifications of accounts which govern this item are a constant threat to its continuance and to the portion of the $8,600,000 included in the $81,554,330.

Deferred charges in the net amount of $16,541,631 shown in Table I consist of $17,412,210 of debt discount and expense (of which over $11,000,000 applied to refunded issues) less $4,798,508 of debt premium and expense, gas conversion expenditures of $1,284,333, appraisal and audit expenses of $382,261 and miscellaneous items of $2,261,335. These amounts for the most part do not represent assets in the usual sense of the word. They generally have no value in liquidation and often are required to be eliminated in reorganization.

To sum up, I repeat that the claim of the preferred at April 30, 1942 is $60,000,000 plus $36,300,000 for dividends in arrears or $96,300,000. The consolidated net assets of Railways applicable to its common stock at April 30, 1942 are shown on a book value basis to be $81,554,330 or $14,745,670 [20] less than the claim of the preferred at the same date, and the book values are subject to the criticisms I have noted. It is not necessary to reduce to precise figures the adjustments which I have previously indicated should be made. My point is that on a realistic basis the

---

[20] It is not possible to give the amount of this deficiency at December 31, 1942. While the claim of the preferred increases to $98,700,000 by reason of accruing dividends, the net earnings of the system to the end of the year would also have to be taken into account.

[fol. 63] deficiency is substantially more than $14,745,670 on a consolidated basis or $18,345,126 on a corporate basis.[21]

The Earnings Basis

I next consider the questions, whether the preferred is being fully compensated and whether there is a value thereafter for the common, on an earnings basis.[22] In a valuation for reorganization purposes capitalization of earnings is recognized as the principal criterion.[23]

The opinion states: "Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise we are unable to find an over-all value of the assets which approaches $98,700,000." I concur. I shall show later why it seems to me that on any realistic basis of capitalizing earnings the system assets fall far short of $98,700,000.

---

[21] Market quotations for the stocks have been as follows:

[22] I have already agreed that "book values" are not controlling.

[23] *Dubois* v. *Consolidated Rock Products Co., Inc.*, 312 U. S. 510 (1941); *Ecker* v. *Western Pacific R. R. Co.*,— U. S.—(March 15, 1943); *Group of Institutional Investors, etc.*, v. *C. M. St. Paul & P. R. R. Co.*,—U. S.—(March 15, 1943). The last two cases raise questions on the appropriate manner of carrying out the principles of the *Consolidated Rock* case with respect to valuation. Another pending case involving valuation where the plan was upheld is: *In re Chicago & Northwestern Ry. Co.*, 126 F. (2d) 351 (C. C. A. 7, 1942), affirming 35 F. Supp. 230. See also: *In re St. Louis-San Francisco Ry. Co.*, 46 F. Supp. 120; *Akron, C. & Y. R. Co.* v. *Hagenbuch*, 128 F. (2d) 932 (C. C. A. 6, 1942).

United Light & Power Company

Market Quotations

Year	$6 Cumulative Convertible First Preferred Class A No Par High	Low	Class A Non-Voting Common High	Low	Class B Common High	Low
1929	110[1]	100[2]	61 7/8	20	125	32
1930	119 3/8	87	56	19 3/8	99 7/8	56
1931	104 1/4	35 3/4	34 1/2	5 3/8	69	10 3/8
1932	53 5/8	8 1/4	9 1/4	1 3/4	14	4
1933	41 1/2	7	9 3/4	1 3/4	12 3/4	2 1/2
1934	24 3/4	5	5 1/8	5/8	6 1/4	1 1/2
1935	31 1/2	3 1/2	3 5/8	5/8	7	1
1936	68	29 1/4	8 3/4	3 3/8	9 1/2	2 3/4
1937	75 7/8	14 1/2	11 3/8	1 7/8	11 1/2	2 1/4
1938	34 1/4	13 1/2	4	1 3/8	4 1/2	1 3/4
1939	36 1/2	19	3	1	2 7/8	7/8
1940	36	16 3/4	1 3/8	5/16	1 1/4	11/16
1941	29 1/2	16 1/2	7/16	3/32	7/16	3/32
1942	23	10 1/2	3/8	1/8	5/16	1/8
3/31-1943	34 3/8	33 3/4	1/2	1/2	1/2	1/2

[1] Offering price in Oct. 1929.
[2] Offering price in May 1929.

[fol. 64] I believe that the best method of valuation for reorganization purposes [24] is to be found in a capitalization of reasonably foreseeable earnings or earning power at an appropriate rate. This is the method which I think ought to be adopted in this case. In addition and more importantly it is consistent with the holding in the *Consolidated Rock* case, in the *Western Pacific R. R. Co.* case and in the *C. M. St. P. & P. R. R. Co.* case. In the *Consolidated Rock* case it was said that the value of the assets of the enterprise must be ascertained in order to determine the appropriate allocation of new securities among the old security holders. As to the method of valuation (one of the main points of difference in this case) it was said that an effort must be made "to value the *whole enterprise* by a capitalization of prospective earnings * * * Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization. Whether or not the earnings may reasonably be expected to meet the in-

[24] The opinion contends that this is a reorganization. While I disagree with this contention, the principles of valuation should not, in this case, be different because the common stock of Railways has to be valued whether we view it as a reorganization or a liquidation.

terest and dividend requirements of the new securities is a *sine qua non* to a determination of the integrity and practicality of the new capital structure. *It is also essential for satisfaction of the absolute priority rule of Case v. Los Angeles Lumber Products Company. Unless meticulous regard for earning capacity be had, indefensible participation of* junior equities in plans of reorganization may result." [25]

I treat the earnings as we have treated them in dozens of reorganization cases under Chapter X of the Bankruptcy Act.[26] That method is as follows:

[fol. 65] I assume for the moment, and only for the moment, annual earnings of $6,185,000 which the opinion characterizes as "a very liberal assumption as to earning power." Capitalizing this amount at a 10% rate, I arrive at a maximum over-all valuation of $61,850,000.[27] This is $36,850,000 less than the claim of the preferred at December 31, 1942, and only $850,000 more than the cash paid by the preferred about 14 years ago.[28]

Thus it appears that valuing the principal asset of Power (the common stock of Railways) on a "very liberal" earnings basis and at too low a rate by the method customarily used by the Commission in reorganization cases indicates

---

[25] Compare statement by the late Justice Brandeis speaking for a unanimous Court in 1935 in *Atlanta, Birmingham & Coast R. R. Co.* v. *United States*, 296 U. S. 33 (1935).

[26] See e. g., *McKesson & Robbins, Inc.*, 8 S. E. C. 853 (1941); *The Higbee Company*, 8 S. E. C. 777 (1941); *La France Industries*, 5 S. E. C. 917 (1939); Griess-Pfleger Tanning Co., 5 S. E. C. 917 (1939).

[27] 10% is in my judgment too low. The data in footnote 11 of the opinion indicate average times—earnings rates of from 8.9 to 10.4 for nine "representative public-utility holding companies." However, it is clear to me that Railways is not as strong a company as most of the companies included in those averages.

[28] According to Moody's Manual 500,000 shares were offered at par and 100,000 shares at 110. This totals $61,000,000. From the record in this case it appears that the proceeds to the company were $58,594,000. The difference of $2,406,000 apparently represents the underwriting spread.

there is no value for the common stock and no basis for its participation. Accepting the rate of 10% and the opinion's findings as to earning power, the preferred is barely being compensated for the cash paid by it 14 years ago. It is not being compensated for its arrearages nor for the prior rights which it surrenders.

The over-all valuation method of capitalizing earnings has been used by the Commission under Chapter X in determining equities among different classes of debt securities and between debt securities and stock. I doubt that any case can be cited under the Bankruptcy Act where we have failed to take this position. Usually it has been given controlling weight.

This has been true whether the debt securities in question were matured or merely deemed to be matured. I do not believe that a claim that the absolute priorities doctrine does not apply in case of debt securities not yet matured could be sustained, or that a Chapter X case can be cited where we have taken that stand. In the *Los Angeles Lum-*
[fol. 66] *ber Company* case one of the reasons given by the District Court for permitting participation by the stockholders in the plan of reorganization was that "by reason of the so-called voluntary reorganization in 1930, the bondholders cannot foreclose until 1944, the old stockholders having the right to manage and control the debtor until that time." In his opinion, Mr. Justice Douglas said that this reason had no validity.

The bonds there were income bonds and the court was unaware of any circumstances which would give the bondholders the right to accelerate the maturity. The court accepted the conclusion that the bondholders and the trustee could not take possession of the property through foreclosure or otherwise until the maturity of the bonds, and, as a corollary, that the stockholders could keep their possession and control until that time. The court *assumed* "that this right or power on the part of the stockholders to keep possession until 1944 was for them a *thing of value*, though there is no finding that the old stock had any value, present or prospective." The court held that that right did not survive the commencement of proceedings under Section 77B. By invoking the aid of the court, the debtor as well as the creditor assumed all the consequences which flow from that jurisdiction, among them, the possibility that

a plan will be approved which eliminates the stockholders completely.

Thus although the court recognized that the bonds were not due and recognized the right of the common stockholders to continue to operate the business as a thing of value, it did not permit that right to interfere with the imposition of the absolute priorities rule, and the giving up of that right did not constitute grounds, by and of itself, for participation of the common.

It is now well established in some jurisdictions that a creditor's claim need not be matured in order that he may restrict his debtor's free disposition of assets. The Uniform Fraudulent Conveyance Act gives him the same right [fol. 67] in this respect as the creditor with a matured claim reduced to judgment. Likewise, the preferred stockholder now has definite standing in court to challenge acts of the company which may be unlawfully detrimental to his interest in the company.[29]

However, it is not possible for me to accept the figure of $6,185,000 which the opinion uses "for the purpose of determining the existing rights of the preferred and common stocks in the enterprise." To arrive at this figure the actual consolidated net income of Railways and its subsidiaries for the five years ended with 1941, together with estimated figures for 1942, are first adjusted to reflect the Railways' system as it was constituted on April 30, 1942. Next, adjustments averaging $769,425 yearly are made for so-called non-recurring charges which were "urged by the management as necessary to a determination of the normal earning power of the system." The result is $6,185,000. My reasons for not being able to accept this figure of $6,185,000 are many.

I begin with the first table of earnings shown in the opinion. This table covers the earnings of Power's system for the period from 1929, when the preferred stock was sold for cash, to 1942, inclusive. All these figures are represented to be actual except those for 1942 which include estimated amounts for the last three months of that year. Ac-

---

[29] *Crimmins & Peirce Co. v. Peabody Acceptance Corporation*, 185 N. E. 383 (Mass. 1933); *Tower Hill Connellsville Coke Co. v. Piedmont Coal Co.*, 33 F. (2d) 703 (C. C. A. 4, 1929); See *General Investment Co. v. American Hide & Leather Co.*, 129 Atl. 245 (N. J. 1925).

cording to the table, preferred dividends were earned and paid on both a corporate and on a consolidated basis through 1931. In 1932 they were earned on both bases, but only ¼ of the preferred dividend requirement, or $900,000, was paid in that year. From 1933 to 1942 the annual preferred requirements of $3,600,000 were never earned on a corporate basis, nor paid. Even on a consolidated basis they were *not* earned in four years, 1933, 1934, 1935 and 1938. While 1938 was a poor year generally for utilities, the failure [fol. 68] to earn the preferred dividend requirement in that year is significant since it shows clearly the effect of leverage in the system. A recession in 1938 of about $2,500,000 in the underlying *gross* revenues was accompanied by a decline of over $2,000,000 in the consolidated *net* income of the system. It may also be noted that on the basis of actual annual consolidated earnings reported since 1932, the low is $986,719 and the high is $6,700,000[30] and the average is $3,840,000—only $240,000 more than the preferred's annual requirements but $2,345,000 short of the assumed earnings of $6,185,000.

Perhaps the most interesting point about this table is that it shows the aggregate preferred dividend requirements for the 13 year period ended December 31, 1941 to have been actually earned on a consolidated basis with $18,478,747 to spare. Of this excess shown, $8,752,796 was paid in common dividends in 1929, 1930 and 1931 which leaves $9,725,951. Add to this the balance of consolidated earned surplus of $7,144,624 at January 1, 1929 and the $35,100,000 of preferred stock dividend requirements during this period which, although shown as earned, were *not* paid and you get $51,970,575.[31] Presumably, if this amount truly represents undistributed earnings there should at December 31, 1941 be consolidated earned surplus of that amount. At that date, however, there was no consolidated earned surplus whatever. The balance of all surplus was precisely zero.

---

[30] This is the estimated net income for 1942. Had the system not obtained the benefit of substantial non-recurring deductions for tax purposes in 1942, this figure would presumably have been much lower.

[31] Using estimated figures for 1942 the opinion arrived at "indicated undistributed consolidated earnings" of $51,525,951 for the fourteen years ended December 31, 1942.

At December 31, 1940, the balance was also precisely zero. And so, too, at the end of 1936, 1937, 1938, and 1939 the balance was likewise exactly zero.[32]

[fol. 69] Actually such "earnings" have been wiped out completely by charges carried directly to surplus.[33] The charges include debt discount, premium and expense written off ($12,807,659), intangibles and plant adjustments written off ($8,701,091); losses on sale of securities and properties including reductions in carrying value of investments ($8,552,647); street railway and other abandoned property written off ($2,739,997); appropriations to retirement reserve, largely in connection with abandonments or prospective abandonments of transportation properties ($7,133,612); and provisions for reserve for investments ($16,603,609). The miscellaneous credits to surplus include profit on sale of securities and properties ($4,982,-557) and gain on sale of reacquired stock ($4,106,736).

I also note that over $14,500,000 of the capital alleged to have been paid in by Power's common admittedly has disappeared. The amount claimed to have been paid in by Power's common is $28,482,745, the balance of common capital at April 30, 1942 is shown by Power's balance sheet to be $13,907,072, which leaves $14,575,673, as the amount which has been used up by various charges. It is difficult to determine precisely what happened to this $14,500,000 on a consolidated basis. The annual reports of the com-

---

[32] This challenging and curious fact was due to following at the end of each year the highly questionable accounting practice of increasing the reserve for investments by an amount exactly equal to the excess of earnings over expenses and other charges. Moreover in 1941 and also in 1937 when expenses and charges happened to *exceed* earnings, sufficient amounts were transferred *from* such reserve for investments to the surplus account with the result that the deficit was eliminated and surplus remained at exactly zero. Clearly, the need or lack of need for a reserve for investments cannot be precisely dependent on whether there were net earnings or losses for the year.

[33] I do not pause to consider which of these charges should have been made to income and not to earned surplus. Most accountants will, I believe, agree that some of them, at least, should have been charged to income.

panies do not contain analyses of consolidated capital surplus for all years. Indeed, the consolidated financial statements of Railways and its subsidiaries contained in Power's 1942 report are not supported by a summary of consolidated earned surplus. I do know that substantial amounts in excess of the stated value of the common capital were credited to capital or paid-in surplus and that in 1936 a reserve for revaluation of investments of about $12,000,000 was provided out of capital or paid-in surplus. Since the reserve in Power's corporate balance sheet at April [fol. 70] 30, 1942 is less than $3,000,000, since there is no capital surplus shown and since the deficit in all surplus is stated to be $1,843,832, it is apparent that substantial losses have been charged off against paid-in capital.

The significance of these net direct charges of $66,000,000 may be tested in another way. If the preferred is permitted its right to cumulative dividends out of the indicated earnings, losses already charged off have been enough to wash out the entire common investment not once, but more than twice.[34]

I now proceed to the opinion's second table showing adjusted earnings for the years 1937-42. One of the principal troubles I have with this table relates to the nature of the adjustments made. The figures shown in Column 2 represent the annual balances of consolidated net income of Railways' system as constituted at April 30, 1942 applicable to Railways' common stock.[35] The consolidated net income of Railways is then adjusted for so-called "non-recurring" expenditures in the aggregate amount of $4,616,546 which has the effect of increasing the average annual net income by $769,425; from $5,415,120 to $6,184,545—which is rounded out at $6,185,000.

---

[34] In addition there are substantial losses inherent in the remaining book assets for which provision had not been made at April 30, 1942. See supra p. 40, ff.

[35] For the 5 years from 1937 to 1941 these balances of Railways' income aggregate about $3,300,000 more than the actual consolidated net income of Power's entire system as shown in Column 1. I assume the difference is accounted for by the interest, expenses and taxes of Power which are not deducted. But is it proper to eliminate the entire amount of $3,300,000? I question whether all of Power's expenses can be so easily eliminated.

The $4,616,546 of so-called "non-recurring" expenses is composed of the following items:

Table II [36]

Amortization of:		
Gas conversion expenditures		$1,737,981
Holding companies' debt discount and expense		1,209,572
Plant acquisition adjustments		642,313
[fol. 71] Transportation property abandonments		510,000
Expenses of utility plant reclassification		455,797
Rate-case expenses		354,336
State commission appraisal and audit expenses		360,420
Installment payments to insurance company under annuity plan for past services of employees		646,527
Miscellaneous (nine items)		1,092,864
		$7,009,810
Deduct:		
Amount assigned to minority interest	$1,212,642	
Federal income tax adjustment	1,180,622	
		2,393,264
		$4,616,546

I question, as does the opinion, the propriety of eliminating these charges in total. However the opinion's assumed figure of $6,185,000 reflects their complete elimination. I concede that some of them may be truly non-recurring items. But common experience indicates that over a period of ten or fifteen years many so-called non-recurring expenses not possible of prediction will recur. Something should be included to cover these contingencies. Most people will agree, for example, that in a public utility sys-

[36] See opinion and Exhibit 14-28 of the Record.

tem as large as Railways, it is reasonable to expect rate-case expenses. Some companies in the system may be so subject at the present time as the opinion indicates. If this is the case, there is a question whether it may not be subject at least to the expenses of defending its rates.

[fol. 72] I note from Table II, *supra*, that $1,737,981 of gas conversion expenses are being eliminated. I also note that there are $1,285,000 of gas conversion expenses carried in the balance sheet as a deferred charge to be spread over future income accounts, and I understand that the management admits two companies may be forced to expend substantial amounts in changing over to natural gas.

Moreover, I have a further difficulty with this type of adjustment. It fails to give recognition to the important fact that both the company and regulatory authorities regard such extraordinary items of expense as appropriate charges against the revenues of the operating utilities. Accordingly, it is customary to allow for such items in the determination of fair and reasonable rates and by the same token to allow for their elimination when the amortization process is completed. If these assumptions are correct, it is entirely erroneous to adjust for gas conversion expenditures, expenses of utility plant reclassification, rate case expense, state commission appraisal and audit expenses, and possibly other items included under miscellaneous. Either such expenses will continue to be incurred or possible loss of revenues resulting from downward revisions of rate must be given consideration.

I note, also from the same table, charges during the period for debt discount and expense of holding companies in the amount of $1,209,572. I understand that these apply to Railways and Continental and are eliminated on the theory that the debt, or the companies, will eventually be out of the picture.

Let us analyze this adjustment. When the bonds in question were sold, bond discount and expense were set up because the proceeds were less than the face amount of the obligations issued. This difference represented in part the cost of issuing the bonds and in part an adjustment of the coupon rate. The real annual interest cost of the money obtained on the bonds is not interest at the coupon rate but instead that amount plus the pro-rata amount of the dis-

[fol. 73] count applicable to each year.[37] Should the debt be paid off prior to maturity,[38] any remaining balance of debt discount and expense must at that time be charged off, since at least the full face amount of the debt must be paid, unless I am to assume that the assets of those companies are insufficient to meet their debts. In forecasting earnings there is no more reason to eliminate amortization expenses of this character than there is to eliminate the coupon interest on the bonds.

From this same Table II and other sources, I note that there are certain charges added back to income which represent amortization of various items presumably once paid for in cash or its equivalent. They seem to be allowed as non-recurring charges on the ground that they were "charges for amortization which do not represent current cash expenditures or depreciation of properties." Illustrative of such charges are amortization of plant acquisition adjustments and street railway property abandonments. It is stated that the management urges that "while charges of this type, when made, constitute bookkeeping deductions against income available for dividends, the application of cash generated pursuant to such amortization programs results in no decrease in asset value, but rather improves the quality of the investment of security holders by transposing intangible items into tangible ones and enhances earnings."

This argument seems persuasive superficially, but does not stand up under scrutiny. I regard it as indefensible at least so far as it deals with plant acquisition adjustments.

---

[37] This Commission has so held in several cases: see *In the Matter of Alleghany Corporation*, 6 S. E. C. 960 (1940); *In the Matter of Associated Gas and Electric Co.* — S. E. C. — (1942) (Securities Exchange Act Release No. 3285A).

[38] I assume here the debt is not refunded. Where the debt is refunded, authority may be found for charging off the old discount at once or for carrying the old discount forward and amortizing it over the life of the refunding issue or over the remaining life of the refunded issue. I have discussed these varying views in an article, "Treatment of Debt Discount and Premiums upon Refunding," which appears in Vol. 73, Journal of Accountancy, at p. 199 (1942).

Such adjustment items are admittedly a part of the cost of [fol. 74] property—the excess over original cost. The amortization thereof is not essentially different from depreciation. This cost should be matched against revenues and it is just as improper to exclude it as it would be to exclude depreciation. Such a theory would permit the showing of excellent revenues by excluding the cost of producing them.

It will be noted from my Table II that $1,180,622 is included as an adjustment for increase of Federal income taxes. I will try to demonstrate how unrealistic this adjustment is in the light of present, and even past, tax rates. The adjustment is based on the premise that if non-recurring expenses are eliminated, taxable income and taxes will be increased. I agree. The amount of $1,180,622, however, includes $681,622 for increased Federal income taxes estimated to result from the elimination of Power. This amount is entirely unrelated to whatever adjustment of taxes should be made with respect to the management's suggested elimination of $7,009,810 of "non-recurring" expenses. I, therefore, deduct $681,622 from $1,180,622. The remainder, $499,000, presumably is to take care of the increased Federal income taxes estimated to result from the elimination of so-called "non-recurring" charges from the balance of income applicable to the common stock of Railways. These charges from 1937 to 1942 totalled $5,797,168 (being the $7,009,810 shown in Table II, less the $1,212,642 assigned to the minority interest). The amount of $499,000 is less than 9% of $5,797,168. For 1942, the sum of the normal and surtax rates for companies filing on a consolidated basis is 42%. But, a 9% tax rate as an allowance for taxes payable on an assumed increase in income is unreasonably low.

What is even more difficult for me to overlook is the failure to guage the extent of the adjustment necessary to reflect a realistic level of Federal income taxes in determining the earnings figure of $6,185,000. The system's past taxes doubtless have been low relative to reported earnings and income because the system practice of charging [fol. 75] many losses directly to capital or earned surplus. Since 1928 such losses have amounted to over $66,000,000. I suspect, however, that a substantial portion of such losses were deductible from income for tax purposes and so sub-

stantially reduced the system's income taxes. Certainly, in determining "earning power," these "non-recurring" tax deductions are of vital significance, and I am convinced that the "assumed earnings" figure of $6,185,000 should be adjusted downward to give effect to them.[38a]

My difficulties with the question of taxes in their relation to earnings do not stop here. As indicated by Power's 1942 annual report the income for that year of Power and its subsidiaries, except Kansas City Power and Light Company and San Antonio Public Service Company, will be included in the consolidated Federal income and excess profits tax returns to be filed by Power and by Traction respectively.[39] Power reports that no excess profits taxes were incurred by any of the companies included in the consolidated returns for 1941, and for the year 1942 there will be no liability for excess profits taxes because Power and Traction each had excess profits credit carry-overs from 1941.

Power's annual report calls attention to three significant facts with respect to the system's 1942 tax returns. The first is that the excess profits credits are subject to review by the Treasury Department. Such review may develop that Traction will have no substantial excess profits credit carry-over to 1943. The second is that while Power will have a substantial carry-over to 1943, the benefit of this carry-over will not be available for periods after its final liquidation has begun, which probably will occur in 1943. The third point is that the tax liability of the companies included in the consolidated return of Power was $546,000 [fol. 76] less for the year 1942 than it was for 1941 because

---

[38a] I realize that future taxes of the system may also be reduced by deductions of items similar to those I have discussed. However, in such case, not only taxes but also income or earned surplus would be reduced.

[39] The Revenue Act of 1942 permits the filing of consolidated Federal income and excess profits tax returns by companies affiliated under certain conditions of stock ownership. Under the Revenue Act of 1941, a consolidated Federal tax return could be filed only with respect to excess profits taxes.

these companies had the benefit in 1942 of substantial tax deductions for interest and debt discount and expense of Power relating to its debentures which became payable on May 1, 1942. These deductions will not recur in 1943.

The same annual report of Power states that the reported total consolidated income taxes of Railways and its tax affiliated subsidiaries for the year 1942 are approximately $4,540,000 less than would be payable if separate tax returns were required to be filed by Railways and each of its subsidiaries.

These facts are significant. They indicate first that in 1942 there were substantial non-recurring deductions which served to reduce taxes and to increase the income applicable to Power's securities. They also indicate that the system earnings for 1942 were substantially affected by large "savings" resulting from the filing of consolidated income tax returns. I agree with the majority opinion that it is impossible to predict whether the privilege of filing consolidated tax returns will be withdrawn or modified. I point out that it is also impossible to predict the aggregate effect on taxes of the dissolution of Power, the indicated reorganization of Railways on undefined terms, and the elimination of Traction upon conditions not now known. These facts emphasize the uncertain nature of the earnings which the opinion assumes for the purpose of determining the rights of the preferred and common stocks.

I next turn to the extreme leverage position of the $6,185,000 of earnings assumed by the majority as being applicable to the common stock of Railways. On the basis of Railways' consolidated net income for the year 1941, adjusted to give effect to the system as constituted at April 30, 1942, the balance of consolidated net income applicable to Railways' common was $4,906,879. I have summarized from this consolidated income account a statement, beginning with the net earnings of the operating subsidiaries, to show the numerous and substantial claims against such net [fol. 77] earnings which must be satisfied before there is anything left for the common. For reasons stated above I have not made any adjustments for so-called non-recurring charges. I might add that the $22,300,000 figure with which I begin represents what is left of $100,900,000 of gross

operating revenues after deducting operating expenses and taxes and adding other income. The statement to which I refer follows:

Condensed Pro Forma Consolidated Net Income of Railways and Its Subsidiaries Applicable to Railways' Common Stock for the year Ended December 31, 1941

	Amount	Percent
Net earnings of operating subsidiaries	$22,285,885	100.0
Interest and dividends on securities held by the public, etc.	8,755,222	39.3
Balance	$13,530,663	60.7
Subsidiary holding and investment companies—		
Interest and dividend revenues	1,768,042*	7.9*
Expenses, interest and taxes, etc.	935,133	4.2
Interest on long term debt	2,631,253	11.8
Dividends on preferred stocks	1,279,528	5.7
Minority interest	2,296,764	10.3
	$5,374,636	24.1
Balance	$8,156,027	36.6
[fol. 78] Railways—		
Interest and dividends	30,597*	0.1*
Expenses and taxes, etc.	731,862	3.3
Interest on debentures	1,352,624	6.0
	$2,053,289	9.2
Consolidated net income	$6,102,738	27.4
Dividends on preferred stock of Railways	1,195,859	5.4
Balance applicable to the common stock of Railways	$4,906,879	22.0

* Denotes red items.

It is painfully apparent that the assets and earnings applicable to Railway's common stock are at the bottom of a highly attenuated pyramid. The balance of $4,907,000 is the remnants of a $22,300,000 original stream of net earnings of operating utilities. It reaches Railways' common only after being strained through large amounts of senior securities of the operating companies, through Continental and Traction, each of which has considerable amounts of publicly held senior securities and through the senior securities of Railways itself.[39a] It is in short what would be available to Railways common if every dollar of applicable earnings were drawn up from every child and grandchild in the system. It will be noted that the balance of consolidated net income applicable to the Railways common is only 22% of the operating subsidiaries' net earnings and it is less than 5% of the gross operating revenues of the subsidiaries. To me this balance of income is exceptionally tenuous for in 1941 a 7% increase in operating expenses [fol. 79] and taxes would have left nothing for Railways' common therefore nothing for anyone in Power. These facts, the distance from the source of earnings and the size of senior claims, speak more eloquently than the optimistic predictions of earnings made by the management and the estimates of earnings used by the opinion.

IV

The opinion does not agree that the rights of the preferred and the common should be judged by counting the preferred at its liquidating value including arrearages. Nor does it agree that they should be judged by comparing that sum either with the book value of the enterprise as reflected in the corporate and consolidated statements of Power or Railways, or with a valuation reached by capitalizing reasonably expected earnings at a rate that reflects

---

[39a] Since its inception the system has had excessive senior securities. For example, one of the subholding companies, Continental Gas and Electric Company, has outstanding $49,500,000 of 5% debentures owned by the public, and more than $11,000,000 of 7% prior preferred stock also owned by the public.

the degree of risk attending the actual realization of those earnings and attending the investment of the capital needed to produce those earnings. In fact the opinion recognizes that on no reasonable basis of capitalizing the estimated earnings will there result a valuation large enough to satisfy the face amount of the preferred's claims.

Instead, what the opinion sets out to do is to measure the respective rights of the preferred and common stocks "not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i.e., as though no liquidation were to take place". To this I reply that if no liquidation is taking place and if the respective rights are not to be determined in terms of the situation created by the statute, it is difficult for me to see any basis for refusing to recognize the present rights of the preferred or indeed for changing them at all. The opinion, however, proposes to measure these rights by examining "into the respective existing interests of the preferred and common stockholders in the earnings of the enterprise", with the purpose of determining whether the assumptions necessary [fol. 80] to arrive at a proposed allocation of assets "fall within the permissible limits of reasonableness". For this purpose, the opinion assumes annual earnings of $6,185,000.[46]

The opinion, however, does not undertake to determine a proper rate of capitalization of these earnings as a basis for determining the value of the enterprise. In fact it does not value the enterprise at all. What it does is to calculate that if dividends are kept current on the preferred stock it will take about 15 years to pay off the arrearages of $38,700,000. This is on the impracticable assumption, which experience belies as the opinion concedes, that all the earnings of subsidiaries applicable to Power can and will be paid to Power and that Power will apply them to the payment of accumulated and current preferred dividends.

Although the opinion states that the possibility of the

---

[46] I have already commented at length upon the opinion's analysis and conclusions as to the earnings history, and future, of Railways. My criticisms apply with equal weight to the propriety of this assumption.

common sharing in the earnings is "remote", nevertheless the opinion permits a 5% but not an 8.8% participation to Power's common stockholders. It is true that the majority's conclusion is stated to be "of necessity one of over-all judgment and not susceptible of mathematical demonstration." But to me there is implicit in reducing an 8.8% participation to about 5% a precision or reliance on something that is not justified by what appears in the opinion or indeed by the facts. The opinion says that "as the participation of the common stock approaches zero it is giving up for the benefit of the preferred stock nearly 100% of its chance of participating in any future earnings in excess of the existing preferences of the preferred. On the other hand, if earnings do not equal such preferences, the preferred stock gives up but approximately 5% of the earnings actually realized." This is literally true, looking at it from one side of the picture. I would prefer to state it in another way. As I see it, Power's common stock relinquishes 95% of nothing in return for 5% of whatever Railways' common may earn.

[fol. 81] The preferred stock having a stated, liquidating, and paid-in value of $60,000,000 with arrearages of $38,700,000 as of December 31, 1942 is asked to accept for its claim 95% of the common stock of Railways. Although the entire common stock of Railways has at its indefensible best a book value of not to exceed $81,554,330 and an optimistically estimated earning power of $6,185,000, the Power common is assigned 5% of this stock carrying a book value of $4,077,716 and a pro rata share in estimated annual earnings of $309,250. Yet the opinion seems to regard the allotment of all of Railways' common to the preferred as "enriching" the preferred at the expense of the common—despite the fact that this book value, admittedly greater than its present value, falls more than $14,000,000 short of equalling the preferred's claims. This is a strange enrichment, especially when we consider that the preferred received no dividends during the long period in which it is claimed the system's assets were being built up through retaining earnings, and when we consider that the preferred which contributed at least two-thirds of the stock investment has received only 55% of the dividends actually paid while

ine common, contributing one-third of the stock investment has received about 45% of the dividends actually paid.[41] [fol. 82] The opinion neglects to value the enterprise. The approach by the majority can be compared with that implicit in which Justice Reed said in the recent *Western Pacific Railroad* case:[42] "It is obvious that the valuation of the whole of a debtor's property, in a simple case without conflicting or divisional liens, will mark, by a mere mathe-

---

[41] The dividend history may be summarized briefly in this way:

Amount contributed:	Common-Stock	Preferred Stock
Cash	$17,121,000	$60,000,000
Other	11,361,745	—
Total	$28,482,745	$60,000,000
Dividends paid	$ 8,752,796	$10,538,118
Dividends per $100 of recorded capital	$30.73	$17.56

In other words, the preferred stock which contributed at least two-thirds of the stock investment (nearly 80% of the cash) received only about 55% of total dividends paid since issuance. The common stock, junior to the preferred as to dividends, contributed less than one-third of the stock investment but received somewhat more than 45% of total dividends paid. The common has received dividends amounting to nearly 31% of its investment (51% of the cash invested) while the preferred's dividends amount to but about 17½% of its investment or less than 1¼% a year. And despite the opinion's finding of "indicated consolidated earnings" of over $51,000,000 since 1932 only one three months' dividend amounting to $900,000 has been paid the preferred since dividends on the common stock were discontinued in 1931. To me, this earnings and dividend history is not to be overlooked in considering whether the proposed 5% participation by Power's common stock is, in fact, "fair and equitable."

[42] *Ecker v. Western Pacific* R. R., — U. S. — (March 15, 1943).

matical computation as to priorities, the claimants who must be found to be without equity in whole or in part."

However, my principal objections to the way the majority reaches its conclusions go deeper than any I have mentioned. If their conclusion resulted from applying the proposition that earnings actual, and reasonably to be expected, are to be capitalized at an appropriate rate for the purpose of determining whether there exists a value for the Railways' common over and above the liquidating value (which includes arrearages) of Power's preferred, and therefore whether Power's common should participate, I would agree with them. In the *Consolidated Rock* case the Supreme Court said that "the value of the assets of the enterprise must be ascertained in order to determine the appropriate allocation of securities among the old security holders." But it is apparent that no such reasoning was followed in the opinion. It is clear from the whole opinion that controlling weight was given to preferred's rights to earnings.[43]

[fol. 83] We are not dealing here with that type of preferred stock which has a preference merely as to earnings. If the majority's theory and not the liquidation theory is to prevail the fair and equitable method seems to me to be to determine first of all whether the preferred is being fully compensated for what it surrenders and then, if anything

---

[43] That such is the position appears from the following statements which I will quote verbatim:

(1) "The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942."

(2) "In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference."

(3) "If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

remains, to give it to the common. This is consistent with the contracts of the two classes of stockholders. It is what the priorities and the rights of the parties require. It is not proper or fair or equitable to determine first what the common should have and give what is left to the preferred. It is not proper to determine whether at some remote day the common may expect some earnings and fail to determine whether the preferred is being fully compensated.

The basis of the preferred right is not its value. It is its contract. That basis includes its prior claim on earnings, its right to accumulate unpaid dividends, its right to receive $105 a share and arrearages in case of redemption, its present arrearages, and also its right to be paid $100 a share plus arrearages (even if the use of capital be necessary) before the common gets anything in case the corporation is liquidated or dissolved. All those rights are being cancelled. The preferred is entitled to full compensation therefor before anything goes to the common. But it is not receiving an amount equal to its present claim, to say nothing of additional compensation for relinquishing its preferences as against Power's common stock. Its claim is $98,700,000 as of December 31, 1942. The book value of the securities it will receive is about $77,100,000 (before the adjustments I have previously noted) and it must not be forgotten that these new shares will govern not only the preferred's future participation in earnings but will measure its distributive share of the assets if liquidation of Railways ever occurs or if Railways is reorganized as the majority opinion [fol. 84] suggests it might have to be. The common stock is allowed to participate in Railways' common to the extent of 173,838 shares having a total par value of $1,216,866 and a total book value of $4,450,000. Upon liquidation of Power, the preferred is entitled to 100 cents of every dollar until it receives $164.50 per share before the common gets anything. Under the plan if Railway liquidates, Power's preferred gets only 94.52 cents of every dollar and the old common gets 5.48 cents.[44] Before the plan Power's preferred was entitled to $6 per share per annum from earnings cumulatively before Power common got anything. Under the

[44] These amounts are based on the actual plan as approved in the supplementary Findings and Opinion. It will be noted that the share allotted the common is roughly 10% greater than the 5% arrived at in the opinion.

plan it shares the earnings with Power's common in the proportion of 95% and 5%.

The opinion seems to regard Power preferred's prior claim on assets for $100 per share (plus arrearages) in liquidation as worthless and as not entitling it to priority now. This I regard as unfair and inequitable, both legally and colloquially.

The opinion seems to admit that Power's preferred stock has senior rights, but it does not seem to realize that those senior rights include not only a prior claim on earnings but also on assets when a liquidation occurs. Liquidation was not in immediate prospect when the corporation was organized and yet the charter provided that *if* it should be liquidated the preferred was to be paid in full for liquidating value and arrearages of dividends before the common was paid anything. That right is not recognized and is being taken away. It is true that this liquidation may not be the fault of the common stockholders. It certainly is not the fault of the preferred.

The opinion seems to me to ignore the fact that the preferred, in consideration of accepting a limited dividend participation, was given a superior claim on assets, if liquidation occurred, and on earnings and the right to accumulate unpaid dividends and the right to receive $105 a [fol. 85] share plus arrearages in case of redemption. The majority opinion states: "The limitation of the preferred stock's dividend to a fixed amount is a valuable right vested in the common stock." I agree. What the opinion neglects is that the prior claim of the preferred to assets as to both liquidation value and arrearages is a valuable right vested in the preferred. The preferred got that right by accepting the limited return which the majority says is a valuable right vested in the common. In arriving at the preferred's participation, to give controlling weight to its limited dividend right at the expense of the concomitant and compensating claim on assets seems wholly wrong. It is directly at odds with these contracts and underlying considerations and most unfair. It is respecting only one part of the bargain.

The opinion seems to claim the preferred has no right to the immediate receipt of dividends. I differ. Upon liquidation the preferred is entitled to accumulated dividends if there are sufficient as-ets to pay them.[45] The majority point

[45] See footnote 3, *supra*.

of view seems inequitable in view of the fact that from 1932 to 1943 no dividends were paid to the preferred but were allowed to accumulate, even though, as the opinion states, there were consolidated earnings of $51,525,951.[46] The cash generated by these earnings was reinvested in the enterprise and in an important degree was used to liquidate indebtedness or to build additional property now included in the asset accounts of the companies. The use, thereof, built up the asset and earnings position of the system in a way which would ordinarily add to the equity of the common stock of Power which controlled the system. This resembles capital for the use of which nothing is paid and when it is proposed not to fully compensate the preferred for the use thereof but in liquidation (or reorganization) to fail to compensate it in full for the cancellation of its [fol. 86] accumualted unpaid dividends, the proposal is eloquent as to its own inequity. (Parenthetically I note that despite the use of these earnings the system has not been able to build an asset or earnings position which affords a valid basis for the old common's participation.)

I am emphatically opposed to any liquidation or reorganization that sacrifices or fails to recognize legitimate values. In case of doubt I would prefer to err, if at all, on the side of optimism. But the legitimate value of Railways' common falls so far short of the claims of Power's preferred that it isn't even close. Indeed it is my conviction that the common's investment in Power was lost years ago, before the passage of the Holding Company Act. I am happy to say that the system's future seems much brighter than the past. The elimination of burdensome and superflous companies, the simplification of others, the concomitant reduction in costs are all to the good and I recognize the careful conduct of the company's affairs by the present management. The plain and unfortunate fact, however, is that this company was handicapped from birth by congenital defects and deformities and picked up a few more thereafter; it was over-capitalized; it was over-pyramided; it paid excessive prices for property; it indulged in dubious accounting. Its whole financial structure was "jerry built"

---

[46] I have shown above that direct charges to surplus have absorbed these earnings. However, for present purposes only, I will accept the majority's statement.

and was of the weakest and most dangerous character. The investors in Power have reaped the whirlwind of winds sowed some years ago by reckless promoters.

April 1, 1943.

[fol. 87] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

SUPPLEMENTAL FINDINGS AND OPINION—April 5, 1943

In our Findings and Opinion herein we pointed out that our approval of the plan for the dissolution of The United Light and Power Company would be withheld unless such plan was amended to provide that the participation of the common stockholders of Power should not exceed approximately 5%. On April 2, 1943 the applicants filed a document in which they accept and adopt the modifications of the plan referred to in said Findings and Opinion of the Commission and in which they request the Commission to take appropriate action to enforce the plan as so modified, pursuant to the provisions of Section 11 (e) of the Act.

The plan as now amended provides for the exchange of 5 shares of Railways' common stock for one share of Power's preferred and one share of Railways' common stock for 20 shares of Power's common, an allocation of 94.52% to Power's preferred stockholders and 5.48% to Power's common stockholders. Under the amended plan the common stock of Railways will have a par value of $7 per share instead of $6 as originally proposed. The aggregate par value of Railways' new common stock to be outstanding upon consummation of the plan as amended, will be $22,216,866, resulting in a reduction in the capital by an amount of $2,581,334 which will be transferred to the paid-in surplus account of Railways.

For the reasons set out in our Findings and Opinion in this matter, an appropriate order will issue approving the amended plan, subject, however, to the several conditions and reservations of jurisdiction noted in such Findings and Opinion. Furthermore, the request of the applicants that we apply to an appropriate Federal court to enforce and carry out the terms and conditions of the plan as approved is granted by the Commission.

[fol. 88] By the Commission (Chairman Purcell and Commissioners Pike, Burke and O'Brien), Commissioner Healy dissenting for the reasons set forth in his opinion of April 1, 1943.

Orval L. DuBois, Secretary. (Seal.)

April 5, 1943.

[fol. 89] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

ORDER GRANTING APPLICATION NO. 14 AS AMENDED

The Commission having directed, by an order entered in this proceeding on March 20, 1941, pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935, that The United Light and Power Company be liquidated and dissolved and that said company make application to the Commission for the entry of any further orders necessary or appropriate for such purpose;

Said order having further provided that said company might submit to the Commission for its approval a plan proposing a method for complying with said order, on a basis which should be fair and equitable to its security holders, and providing for a determination of the relative rights and interests of its security holders in connection therewith;

The Commission having expressly reserved in said order jurisdiction to enter such further orders in this proceeding as may be necessary or appropriate for the purpose of carrying out the steps required by said order;

The United Light and Power Company, a Maryland Corporation, and its subsidiary, The United Light and Railways Company, a Delaware Corporation, both of which are registered holding companies, having filed a joint application (designated as Application No. 14), pursuant to Sections 11 (b) and 11 (e) of the Public Utility Holding Company Act of 1935 and the requirements of said order of March 20, 1941, proposing a plan for the completion of the liquidation and dissolution of The United Light and Power Company and providing, among other things, for the contribution of cash and minor investments by The United Light and Power Company to The United Light and Railways Company, the distribution by The United

Light and Power Company of the remaining asset consisting of all outstanding common stock of The United Light [fol. 90] and Railways Company among the preferred and common stockholders of The United Light and Power Company and for a determination of the manner and the basis of such distribution;

A public hearing on said Application No. 14 having been held pursuant to appropriate notice at which the applicants and all their security holders and other interested persons were given an opportunity to be heard, and the Commission, on the basis of the record, having made and filed its Findings and Opinion dated April 1, 1943, proposing certain modifications to said plan and finding that the plan if modified in accordance with said Findings and Opinion would be fair and equitable to the persons affected thereby and necessary to effectuate the purposes of Section 11 (b) of the Act; and

A document having been filed in this proceeding on April 2, 1943 in which the applicants accept and adopt the modifications of the plan referred to in said Findings and Opinion of the Commission, and in which the applicants request the Commission to take appropriate action to enforce the plan as so modified, pursuant to the provisions of Section 11 (e) of the Act;

The Commission now finds, on the basis of its Findings and Opinion herein dated April 1, 1943, and its Supplemental Findings and Opinion dated April 5, 1943, that the plan as modified by the applicants is fair and equitable to the persons affected thereby and is necessary to effectuate the provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935, and should be approved subject to the conditions hereinafter enumerated.

The United Light and Power Company, pursuant to the provisions of Section 11 (e) of the Act, having requested the Commission to apply to an appropriate Federal Court, in accordance with the provisions of subsection (f) of Section 18 of the Act to enforce and carry out the terms and provisions of the plan as modified;

[fol. 91] It is hereby ordered, pursuant to Section 11 of the Act and particularly subsections (b) and (e) thereof, and pursuant to all other applicable Sections of the Act, that the plan set forth in Application No. 14 as modified be and the same is hereby approved; said approval by the

Commission shall not, however, be operative to authorize the consummation of transactions therein proposed until an appropriate federal district court shall upon application thereto enter an order enforcing the plan.

It is further ordered that the accounting entries submitted by the applicants necessitated by the various transactions comprising the plan as modified are approved under the applicable Sections of the Act, and the Rules thereunder.

It is further ordered that, in carrying out paragraph 11 of the plan as modified, The United Light and Railways Company shall, upon its acquisition of the securities of Mason City and Clear Lake Railroad Company and La Porte Gas and Electric Company, be bound by the orders of this Commission directing The United Light and Power Company to divest itself of its interest in said companies.

It is further ordered that the issues, transfers and exchanges of securities specified and itemized below are necessary and appropriate to effectuate the provisions of Section 11 (b) of the Public Utility Holding Company of 1935, 49 Stat. 820 (U. S. C., Title 15 Sec. 79k (b)):

(a) The issuance by The United Light and Railways Company of 3,173,838 shares of new $7 par value common stock and the exchange thereof for its outstanding 708,520 shares of $35 par value common stock in accordance with the plan as modified.

(b) The delivery of said 3,173,838 shares of common stock of The United Light and Railways Company by The United Light and Power Company to a depositary for distribution to the preferred and common stock-[fol. 92] holders of The United Light and Power Company in accordance with the plan as modified.

(c) The transfer of not exceeding 3,173,838 shares of $7 par value common stock of The United Light and Railways Company in exchange for outstanding preferred and common stocks of The United Light and Power Company or in exchange for scrip of The United Light and Railways Company in accordance with the plan as modified.

(d) The surrender of 600,000 shares of $6 cumulative preferred stock, 2,421,192 shares of Class A common stock and 1,055,576 shares of Class B common

stock of The United Light and Power Company in exchange for shares of $7 par value common stock or scrip of The United Light and Railways Company in accordance with the plan as modified.

(e) The issuance, transfer and exchange of scrip of The United Light and Railways Company and the issuance or transfer of $7 par value common stock of said Company in exchange therefor to the extent necessary to carry out the plan as modified.

(f) All other transfers and exchanges of common stock and scrip of The United Light and Railways Company which are required in order to carry out the plan as modified.

(g) The transfer by The United Light and Power Company to The United Light and Railways Company of $324,000 principal amount of First Refunding Mortgage 6% bonds, due June 1, 1932 and 100 shares of no par value capital stock of Mason City and Clear Lake Railroad Company, and 7,500 shares of $100 par value capital stock of La Porte Gas and Electric Company in carrying out the provisions of paragraph 11 of the plan as modified.

[fol. 93] This paragraph is included in view of Section 1808 (f) of the Internal Revenue Code and is intended to cover all issues, transfers and exchanges of common stock and scrip of The United Light and Railways Company to preferred and common stockholders of The United Light and Power Company and all other transfers of securities which are required in order to consummate the plan.

It is further ordered that pending final determination of the amounts, upon consummation of the plan as modified and completion of the record, the Commission reserves jurisdiction to pass upon the reasonableness of all counsel fees.

It is further ordered that counsel for the Commission be, and they are hereby authorized and directed to make application forthwith on behalf of the Commission to an appropriate Federal Court to enforce and carry out the terms and provisions of the plan as modified, pursuant to the provisions of Section 11 (e) of the Act and in accordance

with the provisions of subsection (f) of Section 18 thereof and the request duly filed herein by The United Light and Power Company.

It is further ordered that The United Light and Power Company shall mail to its stockholders of record a copy of the Findings and Opinion entered herein, together with a copy of this Order, and shall give notice of the date set by the Court for hearings on said application by mailing to such stockholders a copy of such Notice of Hearing as the Court may direct.

It is further ordered that within 30 days after the distribution date defined in the plan as modified the applicants shall file a Certificate of Notification advising the Commission of the steps which have been taken to consummate the plan.

By the Commission.

Orval L. DuBois, Secretary. (Seal.)

[fol. 94] In the United States District Court, District of Delaware

Opinion—July 30, 1943

John F. Davis, solicitor, Roger S. Foster, counsel, Robert M. Blair-Smith, executive assistant, John W. Christensen, for the Securities and Exchange Commission.

Donald R. Richberg (Davies, Richberg, Beebe, Busick & Richardson) of Washington, D. C. John Dern (Sidley, McPherson, Austin & Burgess), of Chicago, Ill., and Clarence A. Southerland (Southerland, Berl & Potter) of Wilmington, Del., for The United Light and Power Company.

Richard B. Hand of New York, N. Y., and Arthur G. Logan (Logan & Duffy) of Wilmington, Del., for Otis & Co., Intervener.

Townsend, Elliott & Munson, of Philadelphia, Pa., for a Committee of Preferred Stockholders of The Commonwealth & Southern Corporation, *amicus curiae*.

Leahy, District Judge:

This matter is here on an application of the Securities and Exchange Commission pursuant to Section 11 (e) and

18 (f) of the Public Utility Holding Company Act of 1935 [1] "to enforce and carry out the terms and provisions of" a plan of action by The United Light and Power Company for the purpose of enabling Power to comply with the provisions of Section 11 (b) of the Act. This court's jurisdiction is based on the fact that Power transacts a substantial portion of its corporate business in this district and thus comes within Sections 18 (f) and 25.

The amended plan designed to effectuate the dissolution of Power in accordance with the Commission's order of March 20, 1941, was approved by the Commission on April 5, 1943. It provides in substance for the contribution of cash and certain investments of Power to its subsidiary, [fol. 95] The United Light and Railways Company, for the reclassification of the preferred and common stocks of Power into a single class of new common stock by way of the distribution of all the common stock of Railways in the ratio of 94.52% to Powers preferred stockholders, and 5.48% to its common stockholders, the assumption of Power's liabilities by Railways, the transfer of Power's remaining assets to Railways, and, finally, the formal dissolution of Power. The distribution to the common stockholders of Power approved by the Commission is less than was originally proposed by the management of Power, who had suggested an 8.8% allocation to Power's present common stockholders. This distribution of a portion of the equity to the old common stock of Power caused one Commissioner [2] to dissent vigorously. Otis & Company, owner of 10 preferred shares, seeks to intervene and objects to approval of the plan, while a committee for the preferred shareholders of the Commonwealth & Southern Corpora-

---

[1] In this opinion I refer to the Securities and Exchange Commission as the "Commission"; to United Light and Power Company as "Power"; to United Light and Railways Company as "Railways", and to the Public Utility Holding Company Act of 1935, 15 U. S. C. A. § 79 as the "Act".

[2] Commissioner Healy filed an elaborate dissenting opinion. The position of the intervenor, Otis & Co., is based largely—if not wholly—upon the arguments advanced in that opinion.

tion, a stranger to these proceedings, filed a brief as *amicus curiae* in opposition to the plan.

Under the amended plan, Railways' authorized common of 1,000,000 shares with a par of $35—all owned by Power—will be increased to 3,500,000 with a par of $7 each share to have one vote. The outstanding 708,520 shares of Railways' common will then be exchanged by Power for 3,173,838 shares of Railways' new stock. The change in par value of Railways' common will reduce the amount of capital from $24,798,200 to $22,216,866, and the difference of $2,581,334 will be credited to Railways' paid-in surplus account.

The objections to the plan raise no issues of fact. The objections merely endorse the views of Commissioner Healy who broke from the majority of the Commission on an issue of law. That issue will be discussed shortly.

[fol. 96] I. Intervention. Otis & Co. once acted as an underwriter for the preferred stock and presently owns 10 shares. The Commission thinks it appropriate to permit Otis & Co. to be heard on their objections to the plan on the ground that Sec. 11 (e) entitles a security holder to have his objections considered by the district court. Power objects to intervention because notice was given on April 21, 1943, under order of this court that the hearing on the plan would occur on June 15, 1943, and any persons who opposed approval and enforcement were required to file their objections on counsel for the Commission and Power on or before June 1, 1943. This, Otis & Co. failed to do. And Power further claims that no excuse for such default or delay has been presented, although Otis & Co. has had knowledge of the proceedings before the Commission for some years. Moreover, Power points out that at no time did Otis & Co. appear in the proceedings before the Commission. Accordingly, Power argues that Otis & Co. should have utilized the opportunity for administrative relief before appealing for judicial relief to correct an error of law on the Commission's part. Finally, Power contends that Otis & Co. should have sought review of the Commission's order of April 5, 1943, in a circuit court of appeals under Sec. 24 (a), which provision requires a party who wishes to exercise his right of appeal to show he is a "party aggrieved" and limits his objections to those urged before the Commission.

I think it may fairly be argued that the appeal provided by Sec. 24 (a) and an opportunity to be held before the district court under Sec. 11 (e) with the concomitant right to appeal under Sec. 25 to, as here, the Third Circuit Court of Appeals, from the District Court's finding, are alternative rights of appeal.

Otis & Co. relies wholly on the ultimate issue of law which split the Commission; and that was a substantial issue of law which must be determined regardless of whether Otis & Co. is in or out of these proceedings. Whether this court [fol. 97] should demand strict compliance with its order of April 16, 1943, and refuse to hear a party who failed to file his objections by June 1, 1943, is obviously a matter resting in the discretion of the court. In this case, I think the exercise of discretion should be in favor of Otis & Co.

Procedural analogies on the right of stockholders to be heard and to appeal in 77 B and Chapter I proceedings in bankruptcy offer some help;[3] but I hardly think them applicable here. In my view, I think Sec. 11 (e) of the Act supports Otis & Co.'s right to intervene, file its proposed answer—containing its objections to the plan—and be heard. In fact, all this is a fait accompli, as I have already heard Otis & Co. at length. Its right to appeal is a matter which does not have my immediate concern. That is a matter which the circuit court may some day be called upon to answer.

II. The Plan. We have merely two issues: (a) is the plan "appropriate to effectuate the provisions of Sec. 11"; and (b) is the plan "fair and equitable."

---

[3] Under Sec. 77 B and Chapter X of the Bankruptcy Act, the right to appeal is tantamount to this statutory right to be heard. In re Day & Meyer, Murray & Young, Inc., 2nd cir., 93 F. 2d 657; In re Barday Park Corp., 2nd cir., 90 F. 2d 595. Creditors at one time had a limited right to be heard. Tetzke v. Trust No. 2988 of Foreman Trust and Savings Bank, 7th cir., 85 F. 2d 942, cert. den. 299 U. S. 609. Chapter X enlarged the rights of both creditors and stockholders to be heard. In re Philadelphia & Reading Coal & Iron Co., 3rd Cir., 105 F 2nd 358; Keystone Realty Holding Co., 3rd cir., 117 F. 2d 1003; and Dana v. Securities and Exchange Commission, 2nd Cir., 125 F. 2d 542. The right to be heard and appeal, therefore, would seem to obviate formal intervention in bankruptcy.

(a) Power is the apex holding company at the top of a pyramid system. There are subholding companies between Power and the base. One of the principal of these is Railways. The common stock of Railways and cash constitute Power's assets. Railways own the securities representing Power's interest and control in the lower companies. Power will eliminate its stock liability through a distribution of its assets in kind, a method, the Commis- [fol. 98] sion has found, which will be both economical and appropriate to effect compliance with Sec. 11 (b).

Prior to the entry of its order of dissolution on March 20, 1941, extensive hearings were had. No appeal was taken from the order, and the time for seeking a judicial review has long since expired. Really the question of necessity for the plan is no longer with us; and critical re-examination of such question is, I think properly, beyond my judicial ken. However, it is clear that the plan is "appropriate to effectuate the provisions of Sec. 11." After review, I accept the findings of the Commission that there is necessity for the plan and for Power to liquidate pursuant to Sec. 11 (b) (2).

(b) Is the plan fair and equitable? The charter of Power provides, inter alia, that "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned) including the full dividends for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock in accordance with their rights at the time of distribution." Admittedly, preferred has a principal claim of $60,000,000 and an accumulated dividend charge of $38,700,000. If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets represented by the common stock of Railways have not a present value equal to that amount. If the contractual preferences are operative it is clear there will be nothing for the common shareholders.

The problem for determination is whether the plan is "fair and equitable." Concededly, the plan does not sat- [fol. 99] isfy the "absolute priority" rule which is applied in equity and bankruptcy reorganizations.[4] Under that rule, no plan can be fair and equitable which permits a junior security to retain an interest in the reorganized corporate enterprise before the securities senior to it have been paid in full (but not necessarily in cash) for the rights which they surrender. The value of the reorganized concern is projectively determined by a capitalization of the "guess" earnings of the new concern and comparing the valuation so arrived at with the total claims of the old senior securities. The present plan fails to meet this test, as junior interests are allowed to participate in the new capital structure of Railways when it is conceded that Railways' common is not worth $98,700,000 on any basis of valuation. If the claims of the preferred stockholders are to be treated as matured as in an equity or bankruptcy reorganization, there can be no participation for the common stock under the "absolute priorities" rule.

It was stated in Consolidated Rock Products Co. v. duBois, 312 U. S. 510, that the method of valuation formulated with respect to railroad reorganizations—which regards an estimate of future earnings the most important criterion—applies equally to industrials. Does this mean that after valuation has been determined, the rights of security holders of a utility must be determined by these same rules in a substantially dissimilar situation?

The Commission concluded that the changed circumstances which a company finds itself in where bankruptcy is present may not be and often is not the changed circumstances a company finds itself in as it attempts to comply with the Public Utility Holding Company Act of 1935. It therefore was of the opinion that "fair and equitable" should be given a different construction under the Public Utility Holding Company Act than had been given in re-

---

[4] Case v. Los Angeles Lumber Products Co., 308 U. S. 106; Consolidated Rock Products Co. v. duBois, 312 U. S. 510; Marine Harbor Properties v. Manufacturers T. Co., 317 U. S. 78; Ecker v. Western Pacific R. Co., — U. S. —; and Institutional Investors v. Chicago, M., St. P. & P. R. Co., — U. S. —.

[fol. 100] organizations in equity and under the Bankruptcy Act,[5] and, in holding bankruptcy techniques inapplicable, consequently refused to treat the claims of the preferred as having matured. The Commission gave participation to the common in the reorganized company, even though the valuation of the reorganized company, as determined by a capitalization of its prospective earnings, was not equal to the $98,700,000 claim of the preferred stock. Having determined that the value of the reorganized company is insufficient to meet the preferred stock claim, the Commission found it unnecessary to make an over all dollar valuation of the company, for it measured and determined participation according to the substantive rights of security holders as they would exist apart from the required reorganization. In the opinion of the Commission, to mature liquidating preferences would be to add to the value of one class of securities at the expense of the other.

This is a new approach to the problem. The quantity of participation, the Commission found, should be expressed in terms of a percentage of the new stock, without being reduced to dollar figures; and this finding is based, of course, on the proposition that the Commission also found it was not detrimental to the interests of investors.

In other words, after capitalizing reasonable prospective earnings, the Commission found that that sum was insufficient to meet the liquidating preferences of the preferred stock by a wide margin. Under the orthodox approach, that would end the problem, and there would be no participation for the common. The Commission, however, to determine participation, projected prospective earnings much further into the future than would be permissible if the rights of the preferred stock were to be treated as matured. In this case, even on the assumption of liberal earning power, and on the assumption that all earnings [fol. 101] were paid to preferred stockholders, it would take fifteen years to pay off the dividend arrearages. The Commission concedes that the possibility of the common acquiring value is remote; but, nevertheless, it was of the

[5] It is significant to note that there is some Congressional dissatisfaction with the "absolute priorities" rule even as applied to reorganizations under the Bankruptcy Act. See H. R. 2857, 78th Cong. 1st Session.

opinion that the common should be accorded this right in the light of the possibility that future earnings may prove to be greater.

There are weighty reasons why the junior security holders should have an opportunity to recoup their losses in the future, even though probability of realization is not apparent from an estimate of the prospective earnings within a reasonable time. Especially is this so where (as here) the financial affairs of the corporation are such that it would not be forced to liquidate apart from the necessity of complying with the provisions of the Act. The mere fact that estimated prospective earnings within a reasonable time are inadequate for the common stockholders to recoup their losses should not form a basis for wiping out their interests when under normal conditions they would be entitled to a continuing participation in the enterprise. In short, the common stockholders should be given a chance to recoup, especially where the reason for liquidation is purely fortuitous, and where the future condition of the new enterprise is based on a surmise.

The statement of the principle behind the decision of the Commission was this: "* * * if a class of preferred stock has a reasonable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of that interest through the operation of the statutory mandate." The majority's apologia for its break with Commissioner Healy is just as adequate. They explained: "It [fol. 102] is pointed out in Commissioner Healy's separate opinion that the words 'fair and equitable' embodied in Section 11 have a settled meaning, as determined by the courts, and that an application of the 'absolute priorities' doctrine must result in no distribution to Power's common stock in this case. But that is because he measures the rights of the preferred stock as they would be measured in bankruptcy cases, and not merely because he follows the 'absolute priorities' doctrine in determining the consequences of the measurement. In other words, we can agree with him

when he says that absolute priorities must be respected, because we think that doctrine simply means that the common stock must not be accorded any participation unless the preferred stock has been fully compensated for its rights and priorities. But there the area of agreement stops, because he says further that the rights and priorities of the preferred stockholders are the same here as in bankruptcy cases, where their claims to liquidation preferences (including dividend arrearages) are treated as matured. In our view it would be unconscionable and contrary to the plain intention of Congress to so hold."

There is nothing sacrosanct about the rights of the preferred, and they are not now asked to give to the common what is exclusively theirs. The rights of all parties must be dependent upon the particular facts of each case which comes before the Commission.

A consideration of the basic facts before the Commission supports its special finding of what is fair and equitable under all the circumstances. True, the preferred has a charter claim of $164.50 per share in cash upon dissolution, as that term is ordinarily understood when total corporate assets are either sold privately or on the block and liquidation, in the sense that total corporate purpose ceases, takes place. But, the Commission has caught the nuance in the present situation. There is no real finality to this particular dissolution. Power's shareholders simply transform themselves into holders of common stock of Railways and [fol. 103] thus obey the demands of Congress. Power as the head of a holding company system is now declassé by congressional mandate; the interests of all classes of stock are nevertheless still lodged in a continuing enterprise.

While the preferred's dividend arrearage is a claim upon capital under, at least, one decision[6] I do not think this claim should black-out considerations of common's contribution to that same capital. Common's contribution to capital amounts to $28,482,745—preferred's $60,000,000. After deduction of dividends, net contribution is $19,729,949

---

[6] Argument that dividend arrearages should not be a claim on capital in all cases made by the writer of this opinion was rejected by the Supreme Court of Delaware in Penington v. Commonwealth Holding Const. Corp., 17 Del. Ch. 394, 155 A. 514, in 1931.

for common and $49,461,882 for preferred. But undistributed earnings have been plowed in since 1929—$4,073,155 by common and $38,700,000 by preferred. And while preferred has a capital claim for its par and an arrearages "capital claim" [sic] on non-existing earnings totalling $98,700,000, the plan should not disregard common's capital claim of $19,729,949.

It is neither an exercise in semantics nor a rejection of labels to consider the present plan little more than a reclassification.[7] If it had donned the formal dress of reclassification by way of merger, the preferred may have been met with the issuance of a new stock with a reduced dividend rate and a wiping out of its dividend arrearage claim. In any such reorganization, the mere pittance of 5.48% of Railways' stock thrown to the common would manifestly be regarded as not only fair and equitable but downright generous to the preferred. But the Commission having determined that an allocation of 95% of the equity should go to the preferred, likewise determined that the shortest way to compliance with the Act was direct liquidation without pausing to go through the legal legerdemain [fol. 104] of recapitalization followed by formal liquidation which, in all probability, would have delayed the time the preferred's investment could be put on a dividend paying basis.

The Act was a command of the government. Contractual relationships must, *ex necessitatae*, give slightly in the face of such legislation. It is my view that Congress never contemplated or intended that preferred shareholders of public utility holding companies were to be, if shrinkage of assets occurred, the sole owners of the corporate enterprise. Moreover, the case history of railroads—which gave rise to the "absolute priority" rule—pressed by increased truck and air transportation competition, is no economic analogue to the electric power industry. The railroad industry is decadent, whereas the electric power industry has all the characteristics of growth. This is an additional

---

[7] In Puget Sound Power & Light Company, Holding Company Act Release No. 4255, approved and enforced by an order of the District Court in Massachusetts on June 10, 1943, there was a recapitalization on a one-stock basis; in short, a recapitalization effected without maturing the liquidation preferences of the preferred.

reason supporting the approach of the Commission in the allocation of participation in the new venture, for the future potentialities of the electric power industry are incalculable.

The approach to values by Commissioner Healy—while based on the facts of Power's earnings—overlooks two propositions: (1) the 1929-38 national depression period for public utilities; and (2) as normal revenues came back into the picture, a heavy taxation schedule made its appearance in the face of an international war. In the light of corporate history, as we have come to know it, such factors of income and expense are abnormalities.

The question remains whether the approach of the Commission can be supported under the language of the Act. This particular problem is one of statutory construction. It is urged that the expression "fair and equitable" as used in the Act is a term of art and has a settled meaning, i.e., that the rule of "absolute priorities" must be followed for the plan to be fair and equitable, and that under the well known rule of statutory construction, Congress must be presumed to have used the language it did use to convey the settled meaning. I refuse to accept the [fol. 105] application of this rule of construction to these proceedings. The Act marks a radical departure from all previous legislation. Moreover, the dominant purpose of the Bankruptcy Act is the elimination of claims without value (See In re 620 Church St. Corp. 299 U. S. 24) *whereas the dominant purpose of the Public Utility Holding Company Act is the enhancement of security values through integration* for the protection of investors. Bankruptcy techniques are wholly inapplicable because Power is not insolvent or in any financial difficulty in the traditional bankruptcy or equity sense. I consequently hold that the expression "fair and equitable" as used in the Act does not have the restricted or formal meaning accorded it by the cases supporting the "absolute priorities" rule.

The test of fairness under the Act does not involve the application of a precise mathematical formula. Fair and equitable are not arithmetical, algebraic, or geometrical. There can be no hard and fast rule when dealing with these terms. The requirements of "fair and equitable," as the Commission correctly concluded, depend upon the particular setting. The words "fair and equitable" may have a definite meaning given them in reorganization in

equity and under the Bankruptcy Act, but they may also have another meaning where a company is attempting to comply with the provisions of the Public Utility Holding Company Act of 1935, *unless the financial condition of such company is such that it faces liquidation apart from the necessity to comply with the statute.*

The majority opinion expresses "a more sensitive regard for what is right and what is wrong" in a distribution of assets under the Act. Hence, the Commission's evaluation of what is fair and equitable prompted it to reject the proposition that the common shareholders should be eliminated from any future interests in that enterprise. In considering whether the plan was fair and equitable to the preferred, the Commission took into consideration that the preferred had no voice in the management. There [fol. 106] was obviously a small distribution of voting power. Class B common, representing about $4,000,000 of book capitalization, exercised the voting control of the whole system having a consolidated capitalization and surplus of nearly $500,000,000.

After careful consideration of the interests of all its shareholders, Power's management in 1940 originally submitted a plan calling for an 8.8% allocation to their common shareholders. The Commission thought the allocation too high. This fact is not without significance. Preferred stockholders cognizant of the plan for over two years made no opposition. Widespread acceptance by a class of shareholders of a tactic which looks to dilute their financial interest in their corporate enterprise is a reality which no court should disregard. It seems to me a powerful argument for court approval of a plan of distribution of the property of a public utility holding company when not only the Commission recommends, but also where the plan is considered by practically all the owners of such property to be fair and equitable. The interest behind the 10 preferred shares of the dissidents, when compared with the 5% allocation to all the common shareholders, might very well fall into the realm of *di minimus.* Such a view brings a rule of life into a rule of law.

In my opinion, the expression "fair and equitable" should be given its ordinary non-technical meaning. As stated before, the dominant purpose of the Act is the protection and enhancement of public utility security values through integration. But the application of the "absolute priori-

ties" test would in many cases wipe out the interests of stockholders who, save for the passage of the Act, would be entitled to a continuing participation in the enterprise. The expression "fair and equitable", in its ordinary connotation, does not impel such a result; and I will not ascribe such an unnatural intention to Congress. Moreover, it must be apparent that, as I have indicated above, there are many ways to effectuate the purposes of the Act; and, in many [fol. 107] cases, the junior securities' holders would be entitled to a participation if other methods of reclassification are utilized. The choice of procedural alternatives should not affect the substantive rights of the common shareholders.

I believe there exists judicial authority which supports the new approach of the Commission. In Securities and Exchange Commission v. Chenery Corp., 87 L. Ed. Advance Opinions, p. 411, the Supreme Court, in considering the fair and equitable standard proposed by the Act, said: "Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts, but these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled, judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law."

The remaining question is whether the particular plan comes within the standards of fair and equitable as set forth in the Chenery Corp. case. I think the plan abundantly meets these standards. The Commission must have considerable discretion and its informed judgment is entitled to considerable weight. There is no suggestion anywhere that, assuming the Commission has the power to give common anything, 5% is too large. And moreover, if the Commission's estimate as to earnings (which estimate furnished the basis of the common's participation) is too high, the preferred stockholders who receive 95% of the common stock are only damaged to the extent of 5% while, if the Commission's estimate is too low, the common stockholders would be damaged to the extent of 95% or more. In view of the uncertainties of the future, and in view of the fortuitous liquidation of the old company I

think the participation accorded the common is fair and equitable to all classes of stockholders.

[fol. 108] Accordingly, I approve the plan as fair, equitable and appropriate to effectuate the provisions of Sec. 11. A proposed form of decree may be submitted.

(S.) Paul Leahy, J.

Dated: Jul. 30, 1943.

[fol. 109] In United States District Court

Decree—August 4, 1943

A certain plan to effectuate the provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 (hereinafter called the Act) having been filed with the Securities and Exchange Commission by The United Light and Power Company, said plan being dated June 29, 1942; and the Commission, after notice and opportunity for hearing, having entered its findings and opinion dated April 1, 1943, approving said plan, subject to the condition that said plan be modified in respect to the participation to be accorded the preferred and common stockholders of The United Light and Power Company; said company having on April 2, 1943, filed an amendment modifying said plan in accordance with the conditions stated in said findings and opinion of the Commission; the Commission, on April 5, 1943, having entered its supplemental findings and opinion and its order approving said plan as so amended, which plan as so modified is hereafter referred to as the "Plan"; and the Commission, after notice and opportunity for hearing, having found the Plan necessary to effectuate the provisions of subsection (b) of Section 11 of the Act, and fair and equitable to the persons affected thereby; and The United Light and Power Company having requested the Commission to apply to a court to enforce and carry out the terms and provisions of the Plan; and the Commission, on April 16, 1943, having filed with this Court an application to enforce and carry out the terms and provisions of the Plan; and this Court by order dated April 16, 1943, having fixed June 15, 1943, as the date for hearing upon the Plan; and it appearing from the affidavit of H. B. Munsell that due and sufficient notice of said hearing was duly given in accordance with the provisions of said order of April 16,

1943; and objections having been filed by certain stockholders of The United Light and Power Company to the Plan; and the Commission, The United Light and Power Company and Otis & Co., a holder of 10 shares of the pre-[fol. 110] ferred stock of The United Light and Power Company, having appeared by their counsel, and this Court having duly considered the Plan, the objections and the evidence, and the Court being fully advised in the premises;

It Is Hereby Found, Ordered, Adjudged and Decreed:

1. Subject to the terms and conditions of the Commission's order of April 5, 1943, as set forth in Exhibit C to its application herein, the Plan is approved as fair and equitable, and as appropriate to effectuate the provisions of Section 11 of the Public Utility Holding Company Act of 1935.

2. Subject to the terms and conditions of said order of the Commission, this Court, for the purpose of carrying out the terms and provisions of the Plan, hereby takes exclusive jurisdiction of The United Light and Power Company and the assets thereof, wherever located.

3. Pending the transfer of its assets in accordance with the Plan, and except as otherwise provided by any order in this proceeding, The United Light and Power Company shall retain possession of its assets and continue the operation of its business through its officers, directors and employees in accordance with its articles of incorporation and its by-laws.

4. The United Light and Power Company, and its officers and directors, are hereby authorized, ordered and directed to take and to cause to be taken, as soon as practical after this order is no longer subject to appeal or review in any higher court, all action necessary on their respective parts to carry into effect the steps and transactions specified in paragraphs 1 to 13, inclusive, of The Plan, which is set forth in "Amendment Number 1 to Application Number 14" before the Securities and Exchange Commission, a copy of which amendment is attached hereto, and made a part hereof.

5. On or before the distribution date referred to in the Plan, The United Light and Power Company shall file with [fol. 111] the Court satisfactory proof that its assets, ex-

clusive of the common stock of The United Light and Railways Company, are adequate to satisfy all its liabilities and expenses in the manner provided in paragraph 11 of the Plan.

6. In accordance with the consent of The United Light and Railways Company, filed herein, the checks distributed in accordance with paragraph 9 of the Plan shall not become void prior to August 1, 1948, and the notation on the face of said checks shall so state.

7. On and after the distribution date referred to in the Plan, the sole right and interest of the holders of the $6 Cumulative Preferred stock, the Class A Common stock, and the Class B Common stock of The United Light and Power Company in the corporation shall be to receive (subject to paragraph 9 of the Plan) the common stock or scrip of The United Light and Railways Company, in accordance with the provisions of the Plan.

8. Jurisdiction of the assets of The United Light and Power Company may be released upon the transfer of such assets as provided in the Plan.

9. All creditors and stockholders of The United Light and Power Company, and all other persons, are hereby enjoined and restrained from doing any act or taking any action interfering with, or tending to interfere with, these proceedings, or with the carrying out of the Plan or any part thereof, including the commencement or prosecution of any action, suit or proceeding at law or in equity, or under any statute in any court or before any executive or administrative officer, commission or tribunal.

10. The Court reserves jurisdiction to enter such supplemental orders and to give such further relief as may be necessary and appropriate to enforce and carry out the provisions of the Plan.

By the Court. Paul Leahy, *United States District Judge.*

Dated August 4th.

[fol. 112] Before the Securities and Exchange Commission

Amendment No. 1 to Application No. 14

In the Matter of The United Light and Power Company, et al., Respondents and Applicants

(File Nos. 59-11, 59-17 and 54-25)

Sections 11 (b) (1), 11 (b) (2) and 11 (e) of the Public Utility Holding Company Act of 1935

To the Securities and Exchange Commission:

The undersigned, The United Light and Power Company (hereinafter called "Power"), and The United Light and Railways Company (hereinafter called "Railways"), hereby amend Application Number 14 in the above entitled proceedings by modifying the Plan set forth on pages 3, 4 and 5 of said Application so that said Plan as modified shall read as follows:

The Plan

(As Modified)

1. The authorized Common Stock of Railways, now consisting of 1,000,000 shares of the par value of $35 each, shall be changed into 3,500,000 shares of Common Stock of the par value of $7 each; the 708,520 shares of Common Stock of said company of the par value of $35 each now outstand-[fol. 113] ing shall be exchanged for 3,173,838 shares of the new Common Stock of the par value of $7 each; and the capital of said company shall be reduced by $2,581,334 by reducing the amount of capital represented by the outstanding Common Stock from $24,798,200 to $22,216,866, the amount of the reduction to be credited to paid-in surplus. These changes shall be effected by appropriate action under the corporation law of Delaware upon the vote or written consent of Power as the holder of all the outstanding Common Stock of Railways.

2. On and after the distribution date (defined in Paragraph 12 hereof) the Common Stock of Railways to be owned by Power after the changes outlined in Paragraph 1 hereof have become effective shall be distributed among

the stockholders of Power in complete liquidation of their rights as such stockholders on the following basis:

> Five shares of the Common Stock of Railways shall be distributed to the holder of each share of the $6 Cumulative Preferred Stock of Power, and, subject to the provisions of paragraph 3 hereof, one-twentieth of a share of the Common Stock of Railways shall be distributed to the holder of each share of the Class A Common Stock and the Class B Common Stock of Power.

3. Each Common stockholder of Power who would be entitled to a fraction of a share of the Common Stock of Railways on the basis set forth in Paragraph 2 hereof shall, in lieu thereof, receive non-interest bearing, non-dividend bearing, and non-voting scrip in bearer form, to be issued by Railways. Such scrip, when combined to aggregate one or more full shares, may be surrendered to Railways on or before, but not after July 1, 1944, in exchange for full shares of Common Stock of Railways. All scrip which has not been surrendered as above provided shall become void, and from [fol. 114] and after July 1, 1944, the holders thereof shall be entitled to no rights whatsoever with respect thereto.

4. The distribution of Common Stock and scrip of Railways pursuant to Paragraphs 2 and 3 hereof shall be made by the Depositary referred to in Paragraph 5 hereof upon surrender to the Depositary by the stockholders of Power of the certificates representing the shares of stock of Power held by them or upon the furnishing by such stockholders of proof satisfactory to the Depositary as to the loss or destruction of such certificates accompanied by indemnity satisfactory to Power, Railways and the Depositary indemnifying Power and Railways (and their transfer agents and registrars) and the Depositary against any liability or expense incurred by making such distribution without requiring the surrender of such certificates. All certificates representing stock of Power so surrendered shall be properly assigned to Power or endorsed in blank. All certificates surrendered to the Depositary shall be delivered to or upon the order of Power for cancellation by it.

5. On or before the distribution date, Power shall deposit with a bank or trust company to be selected by it

(herein called the "Depositary") certificates representing the shares of Common Stock of Railways to be distributed to the stockholders of Power. Power shall irrevocably authorize the Depositary to transfer said shares or to cause the same to be transferred to or upon the order of the stockholders of Power entitled thereto in accordance with the provisions of the Plan. Whenever scrip certificates are required for distribution in accordance with Paragraph 3 hereof, the Depositary shall surrender to Railways certificates representing full shares of its Common Stock and Railways shall deliver to the Depositary in exchange therefor scrip certificates aggregating the number of full shares [fol. 115] so surrendered. Railways shall at all times, to and including July 1, 1944, reserve in its treasury for delivery in exchange for outstanding scrip such number of shares of Common Stock as shall equal the aggregate number of shares exchangeable for such scrip.

6. At least fifteen days prior to the distribution date, Power shall mail or cause to be mailed to each stockholder of record a notice advising such stockholders of the procedure to be followed by them in connection with the distribution of Common Stock of Railways pursuant to the provisions of the Plan. A similar notice shall be published in at least one daily newspaper of general circulation published in the Borough of Manhattan, City and State of New York, and at least one daily newspaper of general circulation published in the City of Chicago, Illinois, at least once in each calendar week (in each instance on any day of the week) for two successive weeks, the first publication to be at least fifteen days prior to the distribution date.

7. The stock transfer books of Power shall be closed on the distribution date, and on and after said date the stocks of Power shall cease to be transferable on its books.

8. If any dividend shall be paid upon, or any other distribution shall be made with respect to, the Common Stock of Railways while any shares thereof are held by the Depositary, the portion of such dividend or distribution applicable to the shares of Common Stock held by the Depositary shall be paid or delivered to the Depositary and held by it for distribution to the persons entitled to the shares of Common Stock of Railways to which such dividend or distribution relates, such distribution to be made

to such persons in accordance with the provisions of Paragraph 4 hereof. Any cash or other property so received by the Depositary as a dividend or other distribution with respect to any shares of Common Stock of Railways which [fol. 116] are thereafter surrendered to Railways in connection with the issuance of scrip pursuant to Paragraph 5 hereof, shall be returned by the Depositary to Railways. While shares of Common Stock of Railways or other securities are held by the Depositary all voting rights with respect thereto shall remain vested exclusively in Power.

9. The right of the stockholders of Power to receive Common Stock or scrip certificates of Railways as provided in Paragraphs 2, 3, and 4 hereof shall expire July 1, 1944. As soon as practicable after July 1, 1944, the Depositary shall sell all shares of the Common Stock of Railways and all other securities at the time held by the Depositary for cash either at public or private sale. The Depositary shall thereupon distribute to the remaining stockholders of record of Power their aliquot portion of the net proceeds of such sale plus their aliquot portion of any cash dividends or distributions held by the Depositary which are applicable to the shares of Common Stock of Railways sold by the Depositary. Such distribution shall be effected by mailing a check for the amount payable to each stockholder of record of Power to the address shown on the stock ledgers of Power. After July 1, 1944, the stockholders of Power shall have no rights whatsoever other than as provided in this paragraph. All checks which have not been presented for payment within one year after the date thereof shall become void and shall bear a notation to such effect on their face. All funds represented by checks becoming void as above provided shall be paid by the Depositary to Railways or its assigns.

10. From and after the distribution date, the holders of the $6 Cumulative Preferred Stock, the Class A Common Stock, and the Class B Common Stock of Power shall have only the rights specifically set forth herein, and all other rights (including voting rights) of such persons as stockholders of Power shall cease and become void on the distribution date.

[fol. 117] 11. Power, after paying or providing for the payment of all its liabilities and expenses and prior to the completion of its dissolution, shall contribute to the paid-in

surplus of Railways all remaining cash, securities and other property (except the Common Stock of Railways) owned by Power or with respect to which Power may have an interest. In this connection, provision may be made for the payment of the liabilities and expenses of Power by the assumption thereof by Railways, but the amount of liabilities and expenses so assumed shall not exceed the fair cash value, as determined by the Board of Directors of Railways, of the assets to be contributed to it by Power.

12. Power shall request the Commission, pursuant to Section 11 (e) of the Act, to apply to a Federal court to enforce and carry out the terms and provisions of the Plan. If the court shall approve the Plan as fair and equitable and shall enter a decree enforcing the Plan and requiring its consummation, the distribution of Common Stock and scrip of Railways to the stockholders of Power in accordance with the Plan shall be made on and after the thirtieth day following the date on which such court decree becomes final and is no longer subject to judicial review. The date upon which such distribution shall be commenced is herein referred to as the "distribution date."

13. As soon as practicable after the distribution date Power shall be dissolved.

Pursuant to Section 11 (e) of the Act, Power hereby requests the Commission, upon the entry of an order approving the foregoing Plan as modified, to apply to an appropriate Federal court, in accordance with the provisions of subsection (f) of Section 18 of the Act, to enforce and carry out the terms and provisions of such Plan as modified.

[fol. 118] Signatures

Pursuant to the Public Utility Holding Company Act of 1935, the undersigned have caused this Amendment to be duly executed on their behalf by their duly authorized officers as of the 2nd day of April, 1943.

The United Light and Power Company, by H. B. Munsell, Vice President. (Corporate Seal.)

Attest: Thos. K. Humphrey, Secretary.

The United Light and Railways Company, by H. B. Munsell, Vice President. (Corporate Seal.)

Attest: Thos. K. Humphrey, Secretary.

[fol. 119] STATE OF ILLINOIS,
County of Cook, ss:

The undersigned being duly sworn deposes and says that he has duly executed the attached amendment dated April 2, 1943, for and on behalf of The United Light and Power Company, one of the companies named therein; that he is a vice president of such company; and that all action by stockholders, directors and other bodies necessary to authorize deponent to execute and file such instrument has been taken. Deponent further says that he is familiar with such instrument and the contents thereof, and that to the best of his knowledge, information and belief, the facts therein set forth are true.

H. B. Munsell.

Subscribed and sworn to before me, a notary public, this 2nd day of April, 1943. K. E. McGraw, Notary Public. My commission expires July 7, 1945. (Notarial Seal.)

[fol. 120] STATE OF ILLINOIS,
County of Cook, ss:

The undersigned being duly sworn deposes and says that he has duly executed the attached amendment dated April 2, 1943, for and on behalf of The United Light and Railways Company, one of the companies named therein; that he is a vice president of such company; and that all action by stockholders, directors and other bodies necessary to authorize deponent to execute and file such instrument has been taken. Deponent further says that he is familiar with such instrument and the contents thereof, and that to the best of his knowledge, information and belief, the facts therein set forth are true.

H. B. Munsell.

Subscribed and sworn to before me, a notary public, this 2nd day of April, 1943. K. E. McGraw, Notary Public. My commission expires July 7, 1945. (Notarial Seal.)

[fol. 121] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

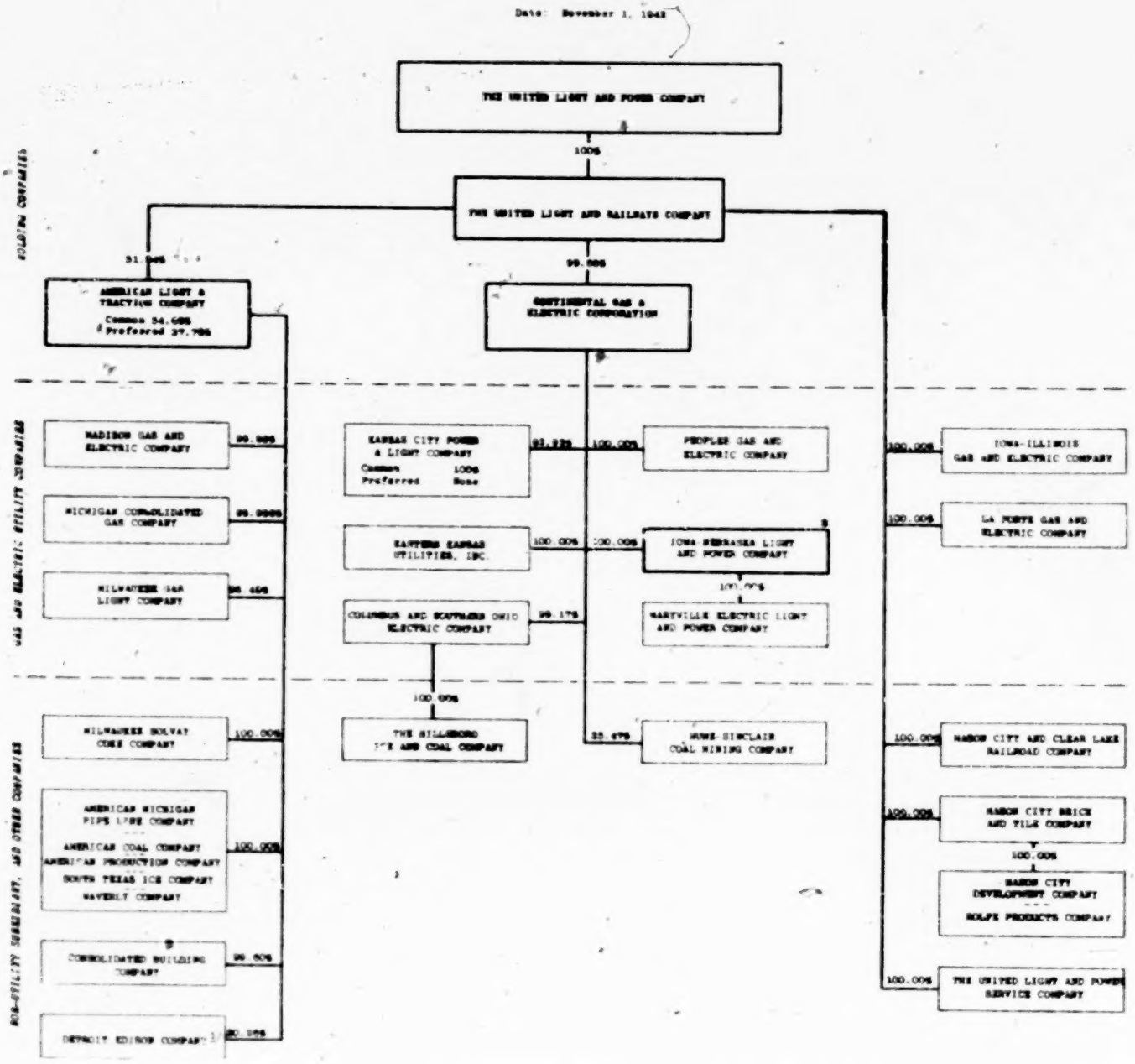
Appendix to Brief for the Securities and Exchange Commission

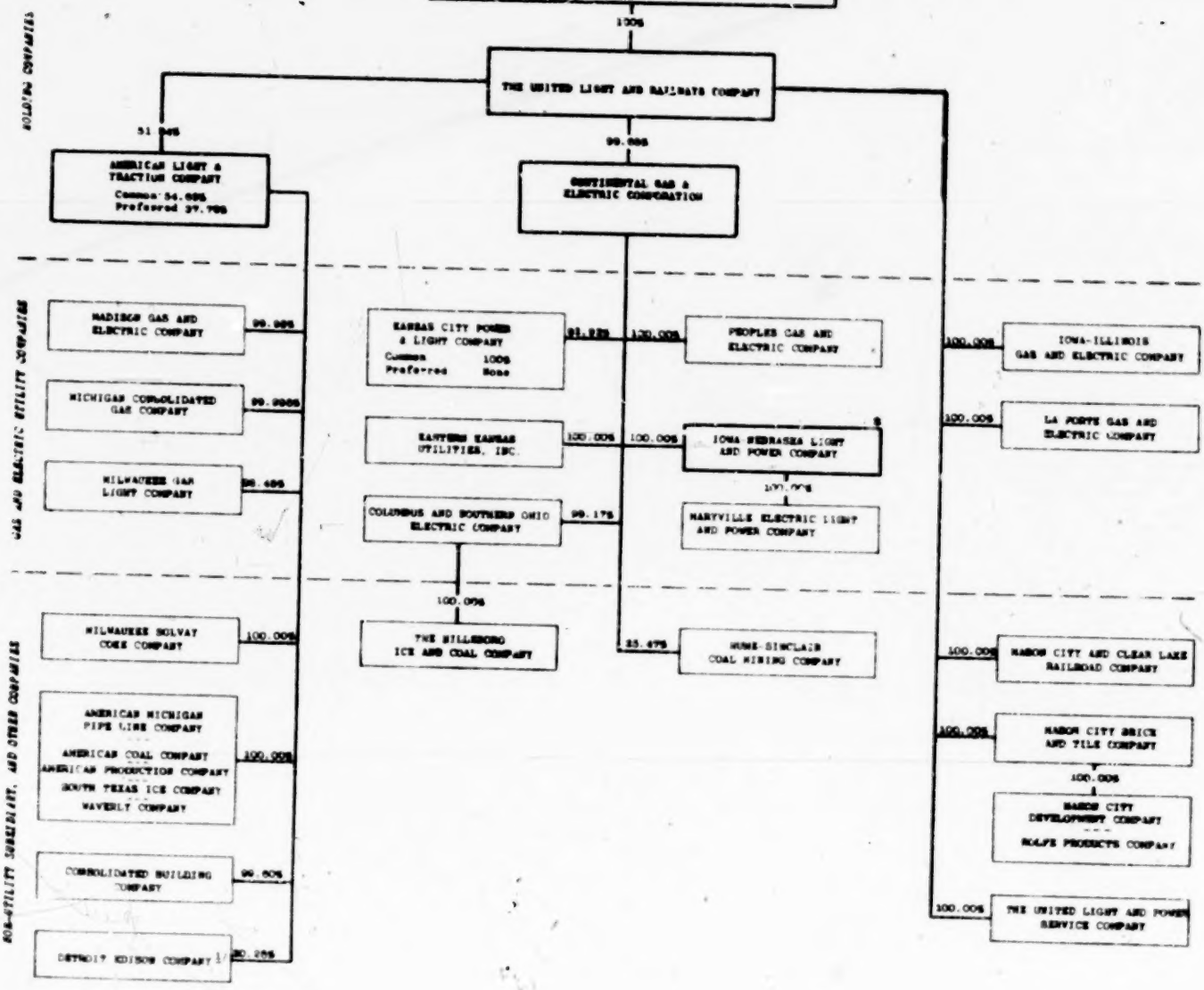
(Here follows 1 photolithograph, side folio 122)

EXHIBIT A

PRO-FORMA CORPORATE CHART OF POWER AND ALL SUBSIDIARIES THEREOF SHOWING THE PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OF EACH SUBSIDIARY HELD BY POWER AND EACH SUBSIDIARY COMPANY THEREOF (a)

Date: November 1, 1943





[*] Iowa-Nebraska Light and Power Company is also a holding company.

NOTE: The figure set forth immediately above the name of each subsidiary company indicates the percentage of the total voting power represented by the securities of the subsidiary owned by the designated holder of the securities of the subsidiary. In cases where less than all the voting securities are owned by the designated holder and the voting securities consist of more than one class of securities, the percentage of each class of voting securities owned by the designated holder is set forth within the rectangle designating the subsidiary.

[1] Exempt as subsidiary by order of commission of August 5, 1940.

[#] The corporate chart printed at page 35a of appellant's brief inadvertently follows the chart in the Findings and Opinion as originally released by the Commission, which contained certain typographical errors. A corrected copy of the Commission's Findings and Opinion was filed with the District Court in connection with the Commission's application for enforcement of the plan. The above corporate chart reflects such corrections.

[fol. 123] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

FINDINGS AND OPINION OF SECURITIES COMMISSION, DATED MARCH 20, 1941 *

(Caption, headnotes, appearances and appended corporate charts omitted.)

These proceedings were instituted on December 6, 1940, by order of the Commission pursuant to Section 11 (b) (2) [1] of the Public Utility Holding Company Act of 1935. Our order was based in large part upon the facts set forth in a [fol. 124] report prepared by our Public Utilities Division, with respect to The United Light and Power Company holding company system as to complying with the stand-

* Not the opinion under review.

[1] Section 11 (b) (2) of the Act makes it the duty of the Commission as soon as practicable after January 1, 1938:

> "To require by order, after notice and opportunity for hearing that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company."

ards of Section 11 (b) (2). The report was filed as part of the proceedings at the time the original order was issued, and was at that time served on the respondents and made available to the public. The substantial accuracy of the facts stated in the report has been conceded by the respondents and no issue of fact has been raised by any interested security holder. The Commission therefore finds that the statements of fact contained in the report of the Public Utilities Division, as subsequently corrected[2] and made a part of the record, are true and correct.

By the Commission's order of December 6, the proceedings then instituted under Section 11 (b) (2) were consolidated with an application previously filed by the Company for approval of a plan of recapitalization under Section 11 (e). That plan contemplated the issuance by The United Light and Power Company of one class of common stock in exchange for the presently outstanding stock of that company consisting of preferred stock, class A common stock, and class B common stock.

The hearing in the consolidated proceeding was convened on January 14, 1940. In order to clarify the issues in the proceeding, we considered it appropriate to sit at the opening of the hearing and we heard opening statements of counsel directed toward the appropriate method of procedure. At that time counsel for the respondents urged that the Commission consider first the recapitalization plan filed by the company; the respondents took the position that the carrying out of that plan would simplify the solution of the remaining problems of the holding company [fol. 125] system. Counsel for the Commission, on the other hand, pointed out that the holding company system as presently constituted failed to meet the mandatory requirements of the second sentence of Section 11 (b) (2),

---

[2] The respondents suggested certain minor corrections in the report as originally filed; these corrections were made in a corrected copy which was subsequently introduced as part of the record. The respondents stated that the facts contained in this corrected copy of the report are true and correct, although they reserved the right to differ with certain of the conclusions and inferences in the report and reserved the right to offer additional facts where they deem them pertinent.

sometimes known as the "great-grandfather" clause, and urged that, unless some cause to the contrary was shown, an order should be entered promptly, as the first step under Section 11 (b) (2), requiring compliance at least with this mandatory provision of the statute. To achieve this purpose counsel for the Commission suggested that as a first step the Commission should order the dissolution of The United Light and Power Company unless a showing was made of other appropriate means of carrying out the statutory requirements. Counsel for the Commission pointed out that in the event that The United Light and Power Company were required to be dissolved, it would be unnecessary to solve many of the problems otherwise required to be solved under the recapitalization plan.

At the conclusion of the initial hearing the Commission adjourned the proceeding until the following week, for the purpose of enabling the Commission to consider the problems of procedure and to afford the respondents opportunity to consult with the Commission's staff on the various problems at issue.

Prior to the next hearing, representatives of the respondents conferred with the Commission's staff with respect to what action should be taken to bring about compliance with the "great-grandfather" clause and with respect to other procedural matters involved in the case. As a result of these conferences, counsel for the respondents presented at the next hearing, held before members of the Commission on January 24, 1941, three alternative methods for bringing about compliance with the "great-grandfather" clause. As a result of the conferences referred to, counsel for the respondents also acquiesced in the procedure suggested by counsel for the Commission of consider- [fol. 126] ing first the issues under the "great-grandfather" clause, rather than proceeding first with the recapitalization plan.[3] At the suggestion of counsel for the re-

[3] In fact, Mr. Richberg, counsel for the company said:

"• • • in the light of progress already made, as heretofore shown, we earnestly urge the approval by the Commission of a procedure along the lines on which we have been working in close coöperation with the Commission's staff, so that waste of time and effort in unnecessary hearings and records may be avoided so far as possible." (Record, p. 94)

spondents, the Commission adjourned the hearing for a month in order that the company might explore further the various considerations involved in each of the suggested methods of compliance to enable it to select one from among the three.

Following this hearing various conferences were held and considerable progress was made. When the hearing was reconvened before us on February 24, counsel for the Commission, after referring to the steps taken at the previous hearing, urged that the Commission again consider whether an order should not be promptly entered directing the taking of specific steps to comply with the "great-grandfather" clause. Counsel for the respondents elaborated in somewhat more definitive form the proposals which they had previously suggested and urged that, in lieu of having a definite order entered at that time, they be permitted to proceed voluntarily to complete the execution of these proposals prior to the entry of any definite order by the Commission under Section 11 (b) (2). The question thus presented was taken under advisement by the Commission.

After consideration we decided that the Commission should at the outset consider whether an order should not be entered promptly requiring compliance with the "great-grandfather" clause. Accordingly on March 1, 1941, we directed that the hearing be reconvened before an examiner on March 12, and that at the reconvened hearing the issues [fol. 127] be limited to a consideration of and to the taking of evidence with respect to what action should be required to be taken by the respondents in order to bring the holding company system into compliance with the requirements of the "great-grandfather" clause. The order also provided that for that purpose the Commission would consider whether one or more of the holding companies in The United Light and Power system should be liquidated, dissolved or merged, or should be required to take other action so that they should cease to be holding companies, and that the Commission would also consider what companies should take such action. It was made plain in the order that the

---

Mr. Richberg, also stated:

"• • • we are not in any way contesting the fact that we should comply with the 'great-grandfather' clause." (Record, p. 95)

limiting of the matters to be considered at the reconvened hearing was without prejudice to the subsequent consideration of other issues under Section 11 (b) (2) in this proceeding.[4]

Pursuant to the order of March 1, the hearing was duly reconvened before a trial examiner and evidence was offered by the respondents as to the steps to be taken to comply with the "great-grandfather" clause. The record is now before us for disposition of these issues.[5]

The Holding Company System

The facts concerning the holding company system of The United Light and Power Company, as far as they are pertinent for present purposes, are fully set forth in the Re- [fol. 128] port of the Public Utilities Division. We do not deem it necessary to repeat all of these facts in detail. However, it may be stated that the holding company system has 23 operating subsidiaries which render electric and gas service in 14 states. In addition, certain of these electric and gas subsidiaries, and certain other companies in the system, conduct transportation, water, heat, ice, coke, and other businesses.

Financial statements introduced by the respondents show that the consolidated assets of the companies of The United Light and Power Company system aggregate as per books nearly $600,000,000. On a corporate basis the assets of

---

[4] Counsel for the respondent stated that it was their hope that, on the basis of the evidence introduced at the hearing an order would be entered which would mark definite progress toward compliance with Section 11 (b) (2) and which might thereafter be supplemented by future orders authorizing or requiring other detailed steps in the course of compliance with the first order.

[5] Counsel for Allied Chemical & Dye Corporation, a substantial security holder of American Light & Traction Company, one of the holding companies in the system, appeared and participated in the hearing. There was present also counsel for Koppers Company, a large holder of Class B common stock of The United Light and Power Company. Opportunity was given to other security holders to be heard and no other evidence or arguments were presented.

The United Light and Power Company are approximately $120,000,000.

The capitalization of The United Light and Power Company, as of December 31, 1940, may be summarized as follows:

The United Light and Power Company

Long Term Debt:		
First Lien 6's due 1952 (a)	$10,578,000	
First Lien 5½'s due 1959	6,678,600	
Total Secured Debt		$17,256,600
Debentures 6's due 1975	10,965,900	
6½% Debentures due 1974	5,534,000	
6½% Debentures due 1973	2,578,000	
Total Debentures		19,077,900
Total Long Term Debt		$36,334,500
Preferred Stock:		
$6 Cumulative at par value (b)		60,000,000
Common Stock—at stated values:		
Class A	9,684,768	
Class B	4,222,304	
Total Common Stock		13,907,072
Total Securities		$110,241,572

[fol. 129] (a) Not callable until April 1, 1947.

(b) Cumulative dividends in arrears—$31,500,000. All surplus has been transferred to a Reserve for Depreciation of Investments.

A corporate structure chart of the holding company system is set forth as Appendix A to these findings. It will be seen from this chart that the holding company system contains five tiers of companies. The system includes eight companies which are holding companies as defined in the Act; arranged according to corporate ownership with rela-

tionships indicated by indentations, these companies are as follows:

The United Light and Power Company
  The United Light and Railways Company
    United American Company
      American Light & Traction Company (A)
    Continental Gas & Electric Corporation
      Columbus and Southern Ohio Electric Company (B)
      Iowa-Nebraska Light and Power Company
    Northern Natural Gas Company

(A) American Light & Traction Company, by virtue of split ownership of its common stock, is a direct subsidiary of both United American Company and The United Light and Railways Company.

(B) Columbus and Southern Ohio Electric Company, while a holding company under the definition of Section 2 (a) (7), by virtue of its ownership of securities of Point Pleasant Water and Light Company, has been exempted from registration pursuant to Section 3 (a) and therefore is not a registered holding Company.

On the basis of the undisputed facts, it is clear that the holding company system does not comply with the require-[fol. 130] ments of the so-called "great-grandfather" clause. The second sentence of Section 11 (b) (2) provides as follows:

> "In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company."

This statutory provision, which is frequently referred to and which we have already referred to as the "great-grandfather" clause, requires that a holding company system be limited to a maximum of three tiers of companies. It is ap-

parent therefore that in order to meet those requirements several companies must be eliminated from the system or other steps must be taken so that such companies will cease to be holding companies.

Dissolution of The United Light and Power Company as a Step in Statutory Compliance

The record here, in our view, provides an ample basis for a finding in this case that The United Light and Power Company should be dissolved as a step toward securing compliance with the requirements of the "great-grandfather" clause. It is apparent from the record that, as the top of the pyramid of the holding company is approached, the effect of increasing corporate complexities accelerates the pressures on security holders of the system. The evidence introduced by the respondents also supports this conclusion.

The respondents' principal witness at the hearing on March 12, was H. B. Munsell, Vice President and Assistant to the President of The United Light and Power Company.[38] [fol. 131] In his testimony, he discussed various financial aspects of the holding company system and considered, in some detail, the elimination of one or more of the holding companies in the system in order to comply with the requirements of the "great-grandfather" clause. He discussed as possibilities, first, the elimination of The United Light and Power Company; second, the elimination of The United Light and Railways Company; and third, the elimination of American Light & Traction Company and Continental Gas & Electric Corporation.

Mr. Munsell expressed the conclusion that of the holding companies in the system The United Light and Power Company lends itself best to dissolution as a means of com-

[38] Mr. Munsell testified that he was a member and secretary of the company's Budget and Control committee, composed of five of the principal executive officers of the holding company, and that the committee decided and determined all matters of policy in so far as they were determined by executive officers. Mr Munsell testified that he was in general charge of all the company's problems under the Public Utility Holding Company Act, and that in his testimony he reflected the views of the company's executive officers.

plying with the "great-grandfather" clause. He described steps which might be taken by the respondents to effect its dissolution. In brief, these steps involve the acquisition by a new operating company, to be known as Peoples Light and Power Company, of the physical property of various direct operating subsidiaries of The United Light and Power Company, frequently known as the "First Lien Companies,"[6] and of United Power Manufacturing Com- [fol. 132] pany,[7] a subsidiary of The United Light and Railways Company. This new company would be owned by The United Light and Railways Company; it would assume the First Lien Consolidated Mortgage Bonds of The United Light and Power Company and would become substituted as the mortgagor in place of The United Light and Power Company. In order to finance this transaction, The United

---

[6] The so-called First Lien Companies are so designated because their securities, and in some cases their physical assets, are pledged as security for the First Lien Consolidated Mortgage Bonds issued or assumed by The United Light and Power Company. The companies are Fort Dodge Gas and Electric Co., Moline-Rock Island Manufacturing Company, Peoples Power Company, Peoples Light Company, Cedar Rapids Gas Company, La Porte Gas and Electric Co., Iowa City Light and Power Co., Ottumwa Gas Company, Tri-City Railway Co. (Illinois), Clinton, Davenport & Muscatine Railway Company, Tri-City Railway Co. (Iowa), and Mason City and Clear Lake Railroad Co. With the exception of La Porte Gas and Electric Co., which the respondents propose to sell, all of the operations of the First Lien Companies are conducted in Iowa and the immediately adjoining area in Illinois. In addition to La Porte Gas and Electric Co., the respondents also propose to dispose of Clinton, Davenport & Muscatine Railway Company and Mason City and Clear Lake Railroad Company. Upon the completion of the consolidation, the new company will have a gross plant account of approximately $41,600,000 with a depreciation reserve of $9,974,000.

[7] United Power Manufacturing Company owns a generating station which is leased to certain of the First Lien Companies, and an office building in Davenport, Iowa, which is used by the Tri-City companies.

Light and Railways Company proposes to sell its investment in Northern Natural Gas Company and certain miscellaneous investments. Funds so received would be used by The United Light and Railways Company to acquire from The United Light and Power Company (through the medium of the new operating company) the properties now controlled by the First Lien Companies. With the funds so received The United Light and Power Company would be able to retire at par [8] all its publicly held debt other than the First Lien and Consolidated Mortgage Bonds.[9]

[fol. 133] The respondents have proposed that The United Light and Power Company sell its interest in Northern Natural Gas Company. Such sale is proposed to be effected by a distribution through underwriters of the common stock of the Northern Natural Gas Company now held in the Portfolio of The United Light and Railways Company. The terms of the proposed sale are not before us and we do not pass upon them; we consider it plain, however, that the disposition of this company is, from the standpoint of The United Light and Power Company holding company system, appropriate if not required under the applicable statutory standards.

The evidence shows that the dissolution of The United Light and Power Company will, together with the taking of certain minor steps, solve the problems presented by the "great-grandfather" clause. The testimony regarding the

---

[8] It is proposed that the debentures of The United Light and Power Company be paid at par. These debentures provide for premiums of 8 or 9 points (for different series) which are required to be paid upon voluntary redemption. Respondents stated that the proposed program could be carried out even though payment of the redemption premium would be legally necessary. Like other details of the proposed program it is unnecessary for us to consider, at least this time, whether such redemption premium must be paid on dissolution.

[9] The respondents propose that the First Lien Bonds be assumed by the successor operating company; they state that under the applicable indenture provisions The United Light and Power Company, upon such assumption, will be released from further liabilities with respect to these bonds.

propriety of dissolving The United Light and Power Company indicated that to bring about that result certain other incidental steps should also be taken.

If these various steps were taken, as outlined by respondents' evidence, The United Light and Power Company would not longer have any debt and its assets would consist almost exclusively of the common stock of The United Light and Railways Company. Upon the consummation of these transactions The United Light and Power Company proposes to distribute this stock to its own stockholders (preferred, Class A common, and Class B common).[9a]

Mr. Munsell indicated that in his opinion the rights of security holders would not be adversely affected. So far as the holders of bonds secured by the First Lien Indenture are concerned, they would continue to have a first mortgage on the physical properties of the "First Lien Companies".[10] [fol. 134] The other debt securities of The United Light and Power Company are proposed to be paid at par. In this connection, he stated that the debentures which are proposed to be paid off at this time are selling at market prices substantially below their par value.[10a]

So far as the stock is concerned, the evidence indicates that the present stockholders of The United Light and Power Company should be benefited by the receipt of common stock of an underlying holding company, since they will

---

[9a] It was recognized that a proposed plan of distribution would have to be approved by this Commission as fair and equitable to those affected thereby.

[10] Except to the extent that certain of these properties might not be included in the new operating company, but some reduction in the total amount of bonds outstanding will result from partial redemption with proceeds from the proposed sale of the La Porte, Mason City and Clear Lake railroad properties.

[10a] While the record does not contain figures showing market prices of these securities in the past, recognized financial publications and the Commission's records in other proceedings show that these debentures have, ever since the year 1931, sold at prices substantially below their par value. Certain of these figures are set forth in our opinion in *In the Matter of The United Light and Power Company* (1940), Holding Company Act Release No. 2348, p. 4.

be that much nearer to the assets and income of the operating companies.

With respect to the effect of the proposed program on the security holders of The United Light and Railways Company, the evidence showed the capitalization of that company, which was as follows as of December 31, 1940:

The United Light and Railways Company

Long term debt—5½% debentures		$24,316,000
Preferred stock (par)		
7% Series	$3,886,900	
6.36% Series	5,312,300	
6% Series	10,083,400	
Total Preferred Stock		19,282,600
Common stock (stated value)	24,798,200	
Paid-in surplus	45,789,200	
Earned surplus	1,827,302	
Total common stock and surplus		72,414,702
Total capitalization		$116,013,302

[fol. 135] As a result of the aforedescribed proposal to eliminate The United Light and Power Company, the outstanding securities of The United Light and Railways Company would be slightly reduced by virtue of the proposed donation by The United Light and Power Company of its holdings of approximately $600,000 of securities of the Railways company to the latter. Paid-in surplus would be increased as the result of this donation together with the additional donation by the Power Company of its holdings of Continental debentures ($607,500), service company stock ($248,600), and the miscellaneous investments. It appears from the record that asset values and earnings of The United Light and Railways Company would both be increased. This increase would result from the proposed acquisition by The United Light and Railways Com, any of the First Lien Properties now owned by The United Light and Power Company. It appears from the testimony that, as a result of carrying out the plan, the new operating company (owning the properties now belonging to the First

Lien Companies) would be in a position to consider refunding its outstanding bonds at substantially lower rates of interest.[11]

The elimination from the holding company system of United American Company presents no substantial problems. United American Company has no publicly-held securities, and its elimination involves merely the transfer of its assets, consisting principally of stock of American Light & Traction Company, to its parent, The United Light and Railways Company.

With the foregoing steps accomplished, there would still remain four tiers of companies in the line of control which runs through The United Light and Railways Company and Continental Gas & Electric Corporation by reason of the fact that the latter has two holding company subsidiaries, namely Columbus and Southern Ohio Electric Company and Iowa-Nebraska Light and Power Company. The Columbus [fol. 136] Company is a holding company by reason of its control of Point Pleasant Water and Light Company, a relatively small company operating in the State of West Virginia, and Iowa-Nebraska Light and Power Company is a holding company by reason of its control of Maryville Electric Light and Power Company, likewise a relatively small company operating in the State of Missouri. Respondents have suggested that, for the purpose of complying with the great-grandfather clause, the two subsidiaries in question should be transferred directly to Continental, or that the Point Pleasant Company might be transferred outside of the system.

It is evident that the taking of these steps, which in themselves appear unobjectionable, would complete the action required to comply with the great-grandfather clause. However, we hesitate to direct the taking of such action at this time by reason of the fact that as a result of the further proceedings to be had herein it may turn out that other holding companies in the system represent unnecessary complexities and may need to be eliminated. Should that be the case the action suggested with respect to the Maryville and

---

[11] Certain of these bonds to be assumed amounting to $10,578,000 are non-callable until 1947; if a refunding is then effected at lower rates of interest, there will result additional savings to the new operating company.

Point Pleasant companies might be unnecessary. It therefore seems to us appropriate at this time to reserve decision with respect to the Point Pleasant and Maryville companies until the other issues referred to are disposed of.

There is set forth as Appendix B of these findings a corporate chart prepared on a pro forma basis to reflect the taking of the various steps proposed by the respondents; there is also set forth as Appendix C a corporate chart showing the various eliminations and changes in the system's corporate structure.[12] It will be observed from these charts that, if the proposed transactions were consummated, The United Light and Railways Company would be the top [fol. 137] holding company of the system, and there would be compliance with the "great-grandfather" clause.

We wish to emphasize that we have considered the various possibilities for the elimination of different holding companies, and the proposed steps which were outlined by the company's witness for the elimination of The United Light and Power Company only as evidence bearing upon the question of which company should be eliminated. It is unnecessary for us to pass upon the various proposed steps to accomplish this result since it is enough for present purposes that action must be taken to comply with the "great-grandfather" clause. It appears, however, that the steps described by Mr. Munsell to effect the dissolution of The United Light and Power Company, are such that in broad outline they are consistent with the statute; this in itself is persuasive evidence that The United Light and Power Company is the company to be dissolved for the purpose of compliance with that clause.

---

[12] These charts continue as separate corporations Tri-City Railway Company (Iowa) and Tri-City Railway Company (Illinois). The respondents have expressed a desire to include the properties of these companies in the proposed new operating company (Peoples Light and Power Company), but have indicated that, if the retention of the properties of the two railway companies is not permissible under the standards of the Holding Company Act, they will be willing to take steps so as to leave these companies as separate corporations which would be direct subsidiaries of The United Light and Railways Company.

Remaining Issues

The first sentence of Section 11 (b) (2) requires the Commission to direct each registered holding company and its subsidiaries to take such steps as may be necessary for eliminating undue and unnecessary complications in corporate structure and for distributing voting power fairly and equitably among security holders of a holding company system. The second sentence of the section, while it contains a specific mandatory provision with respect to eliminating all companies in excess of three tiers, is in our view not a limitation of the more general provision contained in the first sentence. It is a minimum criterion for simplification. Even though a holding company system may comply with the requirements of the second sentence, it must still take further action if the corporate structure is such as to [fol. 138] include any undue or unnecessary complexities or if there exists unfair or inequitable distribution of voting power.[13]

Conclusions

Under the circumstances of this case and on the record presented, we find that the liquidation and dissolution of The United Light and Power Company and United American Company are steps necessary to comply with the requirements of the statute. Accordingly, we conclude that an order should be entered at this time directing the liquidation and dissolution of these two companies. Our order will provide that the respondents shall proceed with due diligence to bring about the liquidation and dissolution of The United Light and Power Company and of United American Company, and that they shall make application to the Commission for the entry of such further orders as may be necessary or appropriate for that purpose; the order will reserve jurisdiction to enter such further orders in this proceeding as may be necessary or appropriate for that purpose.

---

[13] In his testimony Mr. Munsell recognized that there were other problems existing under Section 11 (b) (2). The issues presented by Section 11 (b) (1) as applied to this system are pending in a separate proceeding. (*In the Matter of the United Light and Power Company*, File No. 59-11; see Holding Company Act Release No. 1961.)

Our order will also provide that the hearing shall be adjourned, subject to call upon such notice as the Commission shall deem appropriate, for the purpose of considering other issues presented under Section 11 (b) (2) and particularly to determine what other steps should be taken, by way of elimination of additional holding companies or otherwise, to bring about compliance with the requirements of Section 11 (b) (2) not disposed of by our present order.

By the Commission (Chairman Frank and Commissioners Healy, Eicher and Pike), Commissioner Henderson being absent and not participating.

Francis P. Brassor, *Secretary.*

[fol. 139] BEFORE THE SECURITIES AND EXCHANGE COMMISSION

ORDER OF SECURITIES AND EXCHANGE COMMISSION, DATED MARCH 20, 1941

The Commission having previously instituted these proceedings pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935; notice having been duly given to all interested persons, and all such persons having been given an opportunity to be heard, with respect to what action should be required to be taken by said respondents to comply with certain of the requirements of said Section 11 (b) (2), particularly the second sentence thereof; and

The Commission having filed its findings and opinion herein, in which the Commission finds, among other things, that the action hereinafter directed to be taken is necessary and appropriate for the purpose of bringing about compliance with the second sentence of Section 11 (b) (2);

It Is Hereby Ordered, pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935, particularly the second sentence thereof, that;

1. The United Light and Power Company shall be liquidated and dissolved.

2. United American Company shall be liquidated and dissolved.

It Is Further Ordered that the respondents shall proceed with due diligence to comply with the foregoing order, and shall make application to the Commission for the entry of any further orders necessary or appropriate for this pur-

pose; and the respondent, The United Light and Power Company, may submit to the Commission herein for its approval a plan proposing a method of complying with Paragraph 1 of the foregoing order on a basis which is fair and equitable to its security holders, and providing for a determination of the relative rights and interests of its [fol. 140] security holders in connection therewith; and jurisdiction is hereby expressly reserved to enter such further orders in this proceeding as may be necessary or appropriate for the purpose of carrying out the steps hereinbefore required in this order.

It Is Further Ordered that jurisdiction be and is hereby reserved to enter such further orders as may be necessary or appropriate with respect to any of the remaining issues in these proceedings and particularly for the purpose of considering what action should be ordered to be taken by the respondents to bring about compliance with the further requirements of Section 11 (b) (2).

It Is Further Ordered that the hearing heretofore held herein be and is hereby adjourned subject to call hereafter upon such notice as the Commission shall deem appropriate.

By the Commission.

Francis P. Brassor, Secretary. (Seal.)

[fol. 141] In the United States Circuit Court of Appeals

Appendix to Brief for United Light and Power Co.

In District Court of the United States for the District of Delaware

Civil Action No. 303

In the Matter of the Application of the Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11(b) of the Public Utility Holding Company Act of 1935, with Respect to The United Light and Power Company

Notice to Stockholders

To the holders of $6 cumulative preferred stock, Class A common stock, Class B common stock of the United Light and Power Company, and to all other persons:

Notice Is Hereby Given, pursuant to an order of the District Court of the United States for the District of

Delaware in the above-entitled cause dated April 16, 1943, that the Securities and Exchange Commission has filed an Application in said Court to enforce and carry out the terms and provisions of a plan, approved by the Securities and Exchange Commission on April 5, 1943, to effectuate the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 with respect to The United Light and Power Company, and that a hearing will be held before the Honorable District Judge, sitting as Judge of said District Court of the United States, at the United States Court House in Wilmington, Delaware, on the 15th day of June, A. D., 1943, at 10:00 o'clock A. M., Eastern War Time, for the purpose of determining whether the Court should enforce and carry out the terms and provisions of such plan, and whether said plan is fair and equitable and appropriate to effectuate the provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 and for such other purposes as may appear necessary or appropriate in the premises.

[fol. 142] Any person who proposes to oppose the enforcement, or the consummation and carrying out of the terms and provisions of said plan or the approval of the plan by said Court, is required by said order of the Court to serve, on or before June 1, 1943, on John F. Davis, Solicitor, Securities and Exchange Commission, 18th and Locust Streets, Philadelphia, Pennsylvania, and on T. K. Humphrey, General Counsel, The United Light and Power Company, 105 W. Adams Street, Chicago, Illinois, copies of the written statement of such objections and shall file such statement on or before such date with the clerk of said District Court of the United States. Such statement of objections shall be addressed to the Commission's application to said Court and to its findings as set forth in Exhibit C to said application, and shall state in detail, and in the manner required for pleadings by the Rules of Civil Procedure, the extent to which such statement challenges the allegations and findings therein contained, together with any affirmative defenses or objections to said application.

The United Light and Power Company, by William G. Woolfolk, President.

April 21, 1943.

[fol. 143] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1943

No. 8463

In the Matter of the Application of SECURITIES AND EXCHANGE COMMISSION to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company.

OTIS & Co., Intervening Preferred Stockholder, Appellant

MINUTE ENTRY—December 23, 1943

And afterwards, to wit, the 23d day of December, 1943, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable John Biggs, Jr., Honorable Charles Alvin Jones and Honorable Gerald McLaughlin, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 20th day of April, 1944, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 144] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1943

No. 8463

In the Matter of the Application of SECURITIES AND EXCHANGE COMMISSION to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11(b) of the Public Utility Holding Company Act of 1935 With Respect to THE UNITED LIGHT AND POWER COMPANY

OTIS & Co., Intervening Preferred Stockholder, Appellant

On Appeal from the United States District Court for the District of Delaware

Before Biggs, Jones and McLaughlin, Circuit Judges

OPINION OF THE COURT—Filed April 20, 1944

By BIGGS, *Circuit Judge*.

The appeal at bar presents for our determination the question of the meaning of the phrase "fair and equitable"

contained in Section 11(e) of the Public Utility Holding Company Act of 1935, 15 U. S. C. A. §79k(e). In view of the exhaustive opinion of the Commission,[1] those of its con- [fol. 145] curring and dissenting members and that of the District Court [2] it is unnecessary to include here an extended statement of facts for the questions before us are primarily those of law.

The United Light and Power Company, a solvent registered holding company, a Maryland corporation, is at the top of The United Light and Power Company system.[3] Immediately below "Power" is another registered holding company, The United Light and Railways Company. Most of the operating subsidiaries of the system are controlled by "Railways" and Power owns all of its common stock. The Commission has found that Power must be liquidated and dissolved in order to simplify the holding-company system as required by Section 11b (2) of the Act, 15 U. S. C. A. § 79k(b) (2). Power has three classes of stock; a class A common, a class B common, and a class A preferred stock, the last being entitled to cumulative dividends. No issue is presented by the present review as to the rights of the common stockholders vis-a-vis each other. It is unnecessary, therefore, to describe these stocks except to say that the B common carries all voting rights in the company. Power's charter provides that on the dissolution or liquidation of the corporation whether "voluntary or involuntary" the holders of the preferred stock "shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned) including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the * * * [preferred] stock in accordance with their rights at the time of distribution."

---

[1] See SEC Holding Company Release No. 4215.

[2] See 51 F. Supp. 217.

[3] There were fifty-two companies included in the system at the time of the hearings before the Commission. Seven of them were registered holding companies.

It is conceded that upon dissolution or liquidation of Power the preferred stock would have a principal claim of [fol. 146] $60,000,000[4] and that accumulated unpaid dividends, as of December 31, 1942, amount to $38,700,000, a total of $98,700,000. Power's principal asset consists of common stock of Railways.[5] It is also conceded by all the parties that the value of Railways' common stock does not amount to $98,700,000.[6] Power and Railways none the less submitted to the Commission joint applications and declarations for the approval of a plan which provided that the common stock of Railways should be distributed to the preferred and common stockholders of Power in the respective ratios of 91.2% and 8.8% and that Power should then be dissolved. The Commission held a hearing on this plan and issued an opinion disapproving the proposed allocation of Railways stock as too generous to Power's common stockholders, but found, Commissioner Healy vigorously dissenting, that a distribution of 94.5% and 5.48% to Power's preferred and common stockholders respectively would be fair and equitable. The plan was modified to accord with the Commission's opinion, was then approved by the Commission and was brought on for hearing before the District Court for the District of Delaware as provided by Section 11(e) of the Act.[7] The court found that the plan was "fair and equitable" and entered an order approving it. The appeal at bar was taken by Otis & Co., a preferred stockholder,

---

[4] The preferred stock issued and outstanding consists of 600,000 shares. These shares were issued in 1929 and 1930.

[5] Power has other assets which are to be used by it under the plan for the liquidation of certain obligations. The details of this part of the plan need not be set out here.

[6] Judge Leahy stated, 51 F. Supp. at p. 221:

"If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets * * * have not a present value equal to that amount. If the contractual preferences are operative it is clear there will be nothing for the common shareholders."

[7] In Commonwealth & Southern Corp. v. Securities and Exchange Com'n, 134 F. (2nd) 747, 751, we pointed out the function of Section 10(e) in carrying out the scheme of the Act.

which had intervened in the proceedings before the District Court.

Certain apparent concessions made by the appellant disappear on examination. The Commission states in its brief that the only question which Otis & Co. has raised is the [fol. 147] legal theory governing the allocations of the stock of Railways. This is not so in fact. In its brief the appellant "incorporates" and asserts the views of Commissioner Healy as set out in his dissenting opinion and those views cover almost every aspect of the case. The appellant therefore makes two major contentions which may be summed up as follows. First, it takes the position that the Commission is without authority to allocate to the common stockholders of Power any stock of Railways because the total value of that stock is insufficient to pay in kind the amount of the claims of the preferred stockholders of Power [8] as they will mature upon the liquidation of Power; that the phrase "fair and equitable" [9] being one of art, requires the application of the "absolute priority" rule of Case v. Los Angeles Lumber Co., 308 U. S. 106,[10] and forbids

[8] The common stock of Railways, for reasons which need not be gone into in this opinion, is the only asset which Power will have available for distribution to its stockholders upon its dissolution. See note 5 *supra*.

[9] The standard "fair and equitable" set out in Section 11(e) is verbally the same as the standard applicable to plans of reorganization under the various provisions of the Bankruptcy Act. See Sec. 77(e), 11 U. S. C. 205(e); former Sec. 77B(f), former 11 U. S. C. 207(f); Chapter X, Secs. 174 and 221(2), 11 U. S. C. 574 and 621(2); Chapter XI, Sec. 366, 11 U. S. C. 766; Chapter XII, Sec. 472, 11 U. S. C. 872; Chapter XIII, Sec. 646, 11 U. S. C. 1046.

[10] Mr. Justice Douglas in the cited case stated, inter alia, 308 U. S. at p. 115, "The words 'fair and equitable' as used in § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations. Hence, as in case of other terms or phrases used in that section, Duparquet Huot & Moneuse Co. v. Evans, 297 U. S. 216, we adhere to the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. Keck v. United States, 172 U. S. 434, 446."

the giving of any interest whatsoever to the common stockholders of Power. In other words when the bourne or goal of liquidation or dissolution of Power is reached, says the appellant, the preferred stockholders' rights will mature and they will become entitled to all the common stock of Railways. Second, the appellant asserts that the allotment to Power's common stockholders of an interest of 5.4% cannot be justified by Railways' earnings, or by those of the system, by the present value of Railways stock or in any other way. This last contention necessarily involves some [fol. 148] discussion on our part of Power's earnings as well as those of the system.

The position of the Commission cannot be stated as briefly. It has found that "The assets of Power are * * * of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000 as of December 31, 1942." The Commission points out that Railways' balance sheets indicate a pro forma book value of $77,954,874 for Railways' common stock on a corporate basis and $81,554,330 on a pro forma consolidated basis and states categorically that the "present book values of assets pro forma are clearly insufficient to cover the liquidation preferences of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise we are unable to find an over-all value for the assets which approaches $98,700,000." The Commission finds that, "If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

How then can the Commission reach the conclusion, in view of the Los Angeles Lumber Co. case, that Power's common stockholders may receive an interest of 5.48%? This question may be answered as follows. The Commission asserts that while the type of liquidation contemplated in the case at bar is "involuntary" it is of a type that could not have been foreseen by the draftsman of Power's charter or by the investors in its stock. Next, it points out that in the Los Angeles Lumber Co. case and in North Pacific Railway Co. v. Boyd, 228 U. S. 482, financial disaster had

overtaken or threatened to overtake the corporate enterprises and that therefore reorganization securities had to be distributed among creditors and other claimants according to their contractual rights, determined as in liquidation; that in contrast Power is a company virtually without debt or financial embarrassments; that its existence is proscribed [fol. 149] by the Public Utility Act of 1935 and because of this fact Power's stockholders are prevented from maintaining their interests in a going concern; that for these reasons the "stockholders affected should be given participations according to their contractual or other rights, determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation preferences • • • [and that] the measure of participation allowed should compensate for the substantive rights of security holders as they would exist apart from the reorganization • • •". The Commission states that in giving effect to the congressional mandate it should not allow the fact of liquidation "• • • to add value to one class of securities at the expense of another class." The Commission concludes that "Where simplification of a system is to be attained through elimination of an unnecessary corporate entity, it is our opinion that the 'fair and equitable' standard does not require us to consider liquidation rights as having matured, and as the sole measure of participation for the preferred stockholders; and it should be immaterial whether the simplification process takes the form of recapitalization, merger or distribution of the assets of a holding company in liquidation. In other words, the 'fair and equitable' standard requires the same recognition of substantive rights irrespective of the method employed in a particular case for obtaining the objectives of Section 11(b) (2)."

The Commission then asserts that "• • • if a class of preferred stock has a measurable interest in an enterprise absent the maturing of liquidation preferences and a proportionately greater interest upon the maturity thereof, it would not be fair or equitable under the statute to give recognition to the greater interest at the expense and to the detriment of the common stock. And conversely, if the common stock has a measurable interest apart from the maturing of liquidation preferences, we must not sanction the destruction of that interest through the operation of the

statutory mandate." Referring specifically to the intent of Congress the Commission finds " * * * that the tech- [fol. 150] niques employed under Section 11 should be those necessary to remove the holding-companies' concentration of economic power over operating utilities and * * * benefit investors generally by giving them more direct interests in the operating properties and earnings to the extent that their holding-company securities represent any real equity therein." The Commission concludes, therefore, that it must judge " * * * the fairness of the plan according to legitimate investment values existing apart from the duty of liquidation imposed by the statute" and that the liquidation preference enters into the question of what is fair and equitable only as "* * * one of the bundle of rights belonging to the preferred stock and affecting its normal value"; that preferences may not be permitted to operate so as to be conclusive in the division of assets between the preferred and common stocks to "accelerate the arrearages and translate them into matured claims at their full face amount, so as to entitle the preferred stock not only to all the assets but also in perpetuity to the entire earning power of those assets," a result which would enrich the preferred at the expense of the common. Fair and equitable compensation will be given to all of the claimants, asserts the Commission, "if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated by it—i. e., as though no liquidation were to take place."; that only in this way can each class of stock be accorded " * * * its proportionate share of the benefits to be gained from the elimination of a useless and expensive corporate entity and from the receipt of a security representing a more direct investment in the underlying assets and earnings of the system."

As to valuation the Commission states that " * * * it is unnecessary to arrive at any specific over-all value for the enterprise or for the preferred and common stocks of Power.", but that it is required "to examine into the respective existing interests of the preferred and common stockholders in the earnings of the enterprise."; that the valuation of the respective interests of preferred and common stockholders cannot be "an exact science" under the [fol. 151] circumstances of the case at bar and that the best it can do is to determine " * * *what assumptions

are necessary to arrive at the allocation, and ascertain whether such assumptions fall within the permissible limits of reasonableness."

The Commission then embarks upon a discussion of the corporate and consolidated net income per books applicable to the preferred and common stock of Power, the preferred dividend requirements and the balance of consolidated net income applicable to Power's common stock from the period from 1929 through 1942. A tabulation is attached to the Commission's opinion and we have reproduced this below.[11] The tabulation shows that Power's corporate [fol. 152] income has not met the dividend requirements of the preferred stock since 1932 but that the consolidated (system) earnings for the same period produced a net balance applicable to the common stock. The Commission points out, however, that it has not been advisable in the past to pass up any substantial part of consolidated earn-

---

11

Years Ended December 31	System Net Income Before Power's Preferred Dividend Requirements		Power's Preferred Dividend Requirements	Consolidated Balance (Deficiency) Applicable to Common Stock of Power
	Corporate	Consolidated		
1929	$2,663,602	$9,971,641	$2,469,505 (a)	$7,502,136 (b)
1930	6,212,264	10,462,450	3,568,613 (a)	6,893,837 (b)
1931	6,956,991	7,819,382	3,600,000 (a)	4,219,382 (b)
1932	4,582,947	4,171,925	3,600,000 (c)	571,925
1933	1,233,591	1,510,925	3,600,660	(2,089,075)
1934	663,188	986,719	3,600,000	(2,613,281)
1935	311,268	2,411,652	3,600,000	(1,188,348)
1936	121,851	4,508,261	3,600,000	908,261
1937	402,139	5,182,602	3,600,023	1,582,602
1938	627,594	3,091,508	3,600,000	(508,492)
1939	2,342,432	4,598,654	3,600,000	998,654
1940	2,365,832	5,266,602	3,600,000	1,666,602
1941	930,813	4,134,544	3,600,000	534,544
Total of 13 yrs.	$29,414,512	$64,116,865	$45,638,118	$18,478,747 (e)
1942 Estimated	1,200,000	6,700,000 (d)	3,600,000	3,100,000
	$30,614,512	$70,816,865	$49,238,118	$21,578,747

a Preferred dividend paid during these years.
b During these years the following common stock dividends were paid:

1929	$1,841,937
1930	3,441,262
1931	3,469,597

None thereafter.

c $900,000 or one-fourth of the annual requirements was paid in 1932.
d Before provision for $160,000 fixed charges on Power's debentures paid on May 1, 1942.
e In contrast, the consolidated surplus at December 31, 1941 was $2,000. The reduction has resulted from the provision for and the elimination of losses during past years.

ings to Railways or to Power and that these earnings have fluctuated widely over the fourteen-year period covered by the tabulation. But it is apparent none the less, that consolidated earnings during the ten years from 1932 through 1941 have come close to equalling the preferred dividends requirements. Also set out in the Commission's opinion is another table, reproduced in part in the footnote below.[12] This tabulation shows the comparative consolidated net income applicable to Railways common stock for the year 1937 through 1942. This includes a statement of earnings [fol. 153] for 1942, based on nine months' actual operations and three months' estimated operations. The table shows that consolidated earnings applicable to the common stock of Railways, subject to certain adjustments which need not be set out here, averaged in excess of $6,000,000 for the five year period from 1937-41 inclusive and about $6,184,000 for the six year period from 1937-42.

Having before it the contents of these tables as well as evidence offered by one of Power's officers as to management's estimates of future earnings the Commission stated, "For the purpose of determining the existing rights of the

---

12

The United Light and Railways Company

Comparative Consolidated Net Income Applicable to Railways' Common Stock for the Years 1937 through 1942

Period	Consolidated Net Income of Power Before Power's Preferred Dividend Requirements	Amount Applicable to Common Stock of Railways Adjusted for System as Constituted at April 30, 1942	Adjustments for Non-recurring Expenditures Netted for Income Taxes	Adjusted Consolidated Balance Applicable to Common Stock of Railways
1937	$ 5,182,602	$ 5,856,311	$ 556,643	$ 6,412,954
1938	3,021,508	3,962,314	749,095	4,711,409
1939	4,598,654	5,118,375	922,575	6,040,950
1940	5,266,602	5,772,567	1,091,483	6,864,050
1941	4,134,544	4,906,879	1,064,738	5,971,617
Total of 5 years	$22,273,910	$25,616,446	$4,384,534	$30,000,989
1942 (9 mos. actual; 3 mos. est.)		6,874,277	232,012	7,106,289
Total of 6 years		$32,490,723	$4,616,546	$37,107,269
5 year average (1937–1941, incl.)		$ 5,123,289	$ 876,907	$ 6,000,196
6 year average (1937–1942, incl.)		5,415,120	769,425	6,184,545

preferred and common stocks in the enterprise, we have assumed earnings of $6,185,000, the average adjusted consolidated income applicable to Railways' common stock for the period 1937-42. However, it must be pointed out that in view of the actual earnings experience and the intangible factors discussed, this figure must be regarded as a very liberal assumption as to earning power." If the $6,185,000 annual consolidated earning figure be adopted, it will, as the Commission points out, require approximately fifteen years for the preferred dividend arrearages to be paid in full, even if all consolidated net earnings be applied to the payment of current and accumulated preferred dividends. In this connection the Commission stated, "* * * it is recognized that at best the interest of the common stock in earnings is remote. Particularly is this true, since, as a practical matter, all consolidated earnings would not be available for disbursement to the preferred and common stockholders. The remoteness of the common stock's participation is also demonstrated by the fact that actual earnings have fluctuated substantially and have never in the past ten years exceeded the figure we are assuming except in 1942." The Commission then concluded, as we have stated, that it could not find that the proposal to allocate 8.8% of Railways stock to Power's common "falls within the permissible limits of reasonableness for a situation of this kind," but found upon consideration of all the circumstances that the "* * * common stock is nevertheless entitled to some participation.", and that "* * * a [fol. 154] participation for the common of approximately 5%, while representing the maximum, would not exceed the permissible limits of fairness, and to secure our approval the plan must be modified to reduce the common stockholders' participation accordingly." [13]

We have quoted at length from the findings and opinion of the Commission because the principles involved in the case at bar are of great public importance and it is necessary for the purposes of this opinion to show the basis of the Commission's decision. It will be observed that the theory of priorities first elucidated by the Commission in Community Power & Light Co.[14] and developed further in

[13] Upon modification as suggested, the Commission adjudged the plan to be "fair and equitable."

[14] 6 S. E. C. 182.

Federal Water Service Corp.[15] has been modified at least by inference by the Commission's decision in the case at bar.[16] There seems to be an unmistakable implication in Federal Water Service Corporation that contractual priorities of preferred stock, no matter how matured, when [fol. 155] matured must be respected. This issue, however, was not squarely before the Commission in Federal Water

---

[15] 8 S. E. C. 893.

[16] See also Puget Sound Power & Light Co., S. E. C. Holding Co. Release No. 4255 (April 28, 1943); Southern Colorado Power Co., S. E. C. Holding Co. Release No. 4501 (August 24, 1943); and Virginia Public Service Co., S. E. C. Holding Co. Release No. 4618 (October 16, 1943). It should be noted that the Commission's decision in Community Power & Light Co. followed the decision of the Supreme Court in the Los Angeles Lumber Co. case by twelve days but that that decision was not referred to in the Commission's decision in Community Power & Light Co. In Federal Water Service Corp. a majority of the Commission agreed with Commissioner Healy "that the absence of imminent liquidation cannot justify a plan as being fair and equitable * * * which destroys the contractual priorities of the preferred." The Commission went on to state, "The difference between our views and * * * [those of Commissioner Healy] is that we consider that the contractual rights of the preferred are substantially different where liquidation is not in the atmosphere. We hold that, in such instances, the preferred is being deprived of nothing to which it is entitled. Where liquidation has not been proposed and need not be compelled a liquidation right is merely one of the bundle of rights which imparts value to a security. Absent liquidation, the liquidation preference of a senior class of stock is only an inchoate right to a future payment, which has no definite maturity date, and which will not mature into a present claim despite failure to pay dividends. In addition to this inchoate right to a liquidation preference, the senior stock has present rights to current and accumulated dividends. This right, however, is not absolute, as is a creditor's right to interest; it is only a relative right vis-a-vis junior classes of stock. These junior classes, conversely, have rights vis-a-vis the preferred stock."

Service Corporation since liquidation was not contemplated. It should be noted that the Commission in the instant case contends that it has in fact applied the "fair and equitable" standard prescribed by Section 11(e) and has not deviated from the substance of the interpretation of that standard by the Supreme Court in the Los Angeles Lumber Co. case. In its order approving the plan as modified it specifically found the plan and its proposed allocation to be "fair and equitable."

Is the Commission's determination correct? We are of the opinion that it is. We think that the essence of the Los Angeles Lumber Co. case is contained in the statement by Mr. Justice Douglas, 308 U. S. 118, that the phrase "fair and equitable" has become "a term of art used to indicate that a plan of reorganization fulfilled the necessary standards of fairness." In Group of Investors v. Milwaukee R. Co., 318 U. S. 423, 565-566, Mr. Justice Douglas stated for the Supreme Court that "It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered." In other words the rights of security holders are to be weighed as exactly as the circumstances permit. If it were possible therefore in the case at bar to arrive at the precise equivalents of the rights of the security holders by the employment of a mathematical formula, the answers given by the exercise of that formula would have to be fulfilled precisely as to each class of security holders in order that the plan of reorganization might achieve the standard "fair and equitable." Each security holder must be compensated as exactly as he can be for that which he is giving up. But though his cup must be filled level to the brim, it must not run over. This much is plain.

There is a vital difference, however, between a 77B or a Chapter X reorganization and that proposed in the case at bar. That difference lies in the fact that the [fol. 156] obligation to pay to the preferred stockholder $100 and accrued dividends on each share of his stock has not matured. It has not matured because the condition of liquidation prescribed by the charter of Power has not occurred. But that condition, says the appellant, will occur, and therefore the rights which accrue to the preferred stockholders on liquidation must be treated by the Commission and by the courts as having accrued already.

Herein we think lies the fallacy of the appellant's argument. Though the preferred stockholders of Power have contract rights which entitle them to the payment of $100 a share and accumulated dividends on liquidation or dissolution of Power, those rights, at least in the absence of insolvency, have not matured and cannot mature for the reason that the congressional mandate contained in the Act strikes across contract rights and the maturities embraced by them, severing them. Though severed, they are not lost for, as we have seen, they must be transmuted as nearly as can be into their equitable equivalents.[17]

As was pointed out by the Circuit Court of Appeals for the Second Circuit in New York Trust Co. v. Securities and Exchange Com., 131 F. (2nd) 274, 276,[18] "Where, through no fault of either party, something necessary for the continued performance of a contract goes out of existence because of some unforeseen circumstance and none of the parties have assumed that risk the contract is regarded as charged with the implied condition that if what is necessary to performance becomes unavailable the contract is no longer binding and further performance is excused." The fundamental doctrine cited is applicable in the [fol. 157] instant case. The contracts between Power and its stockholders and the contracts between the stockholders *inter sese* have come to an end because Congress has decreed it. The corporation no longer possesses the power to perform its contract with its preferred stockholders. The corporation therefore is no longer bound to the performance of

---

[17] Such a situation arising under the Public Utility Act of 1935 is analogous to those which have frequently arisen under the Anti-Trust Acts where contract rights must be set aside in order to effectuate the judgment of the contract and to avoid the continuation of the prohibited monopoly. See such cases as Ethyl Gasolene Corp. v. United States, 309 U. S. 436, 455-456; United States v. Int. Harvester Co., 274 U. S. 693, 704-705. Cf. United States v. Reading Co., 226 U. S. 324, 357-358, and Eastern States Lumber Ass'n v. United States, 234 U. S. 600, 606.

[18] The Court affirmed the Commission's ruling that Power should not be compelled to pay off the holders of its debentures at a premium because they had been called prior to maturity despite a contract provision to that effect.

that contract and the preferred stockholders are no longer entitled to its performance. This does not mean, however, that the value of the preferred stockholders' rights must not be transmuted into their equitable equivalents, but if that is done, the plan of reorganization must be deemed to be fair and equitable within the ruling of the Los Angeles Lumber Co. case.

Since the fundamental standard prescribed is that of fairness, the Commission correctly has treated the acceleration right of the preferred stockholders as one to be weighed with all other rights in arriving at the determination of what is fair for the preferred and common stockholders of Power. To permit the preferred stockholders of Power to take all of the common stock of Railways because as an incident in the plan for the simplification of the holding-company system their preferences are to be deemed to be matured would be to bestow a windfall on the preferred stockholders. The fact that the dissolution and liquidation of Power is to be effected under the congressional mandate imposed by Section 11(b) (2) of the Public Utility Act of 1935 instead of those imposed by Section 77B or Chapter X of the Bankruptcy Act is of particular significance for the reason stated but because of other considerations as well. First, it was the intention of Congress in enacting the Public Utility Act of 1935 to preserve the values of securities and not to destroy or diminish their values. The legislative history of the Act makes this clear [19] Congress did [fol. 158] not intend that maturities of securities should be

[19] Reference was made to the techniques developed by the courts in applying the Sherman Anti-Trust Act and the Commodity Clause of the Hepburn Act. These were referred to as permitting "* * * readjustments and reorganizations, without the acceleration of indebtedness or the maturing of rights upon liquidation, to enable corporations to rearrange their corporate structures and divest themselves of properties to the extent required to comply with Government policy." See H. R. Rept. 1318, 74th Cong., 1st Sess. at pp. 49-50, and the "Additional views" of Congressman Eicher, appended to the House Report to accompany S. 2796. Congressman Eicher cited the case of Continental Company v. United States, 259 U. S. 156, 171, in which the Supreme Court stated, "The power of the Court under the Sherman Anti-Trust Law to disregard the letter and legal

accelerated to give any creditor or stockholder a special position to the detriment of any other party in interest in the corporate enterprise. We come therefore to the legal question [20] whether the plan here in issue is "fair and equitable" within the meaning of that phrase as used in Section 11(e).

We think that it is. In making this statement we do not arrogate to ourselves the functions of the Commission or of the District Court. Our jurisdiction is prescribed by Section 25 of the Act, 15 U. S. C. A. § 79y, as was that of the District Court. The learned District Judge specifically approved the plan as "fair and equitable".[21] Section 24(a), 15 U. S. C. A. § 78y, provides that "The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." This court cannot make findings and review the evidence as if *de novo*. But, if we were entitled to do so, we would find that the plan was "fair and equitable" for reasons closely akin to those given by the Commission and by the District Court.[22] Those reasons are set out in the following paragraphs.

---

effect of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law we cannot question."

The President of the United States in his message to Congress of March 12, 1935 stated that the measure "* * * would not destroy a penny of actual value of those operating properties which holding companies now control and which holding companys' securities represent insofar as they have any value." See S. Rept. 621, p. 2, 74th Cong., 1st Sess.

[20] See Case v. Los Angeles Lumber Co., 308 U. S. at p. 119.

[21] The court, as did the Commission, also found the plan appropriate to effectuate the provisions of Section 11. No one doubts that appropriateness.

[22] We conclude that the decision of the Supreme Court in Securities and Exchange Commission v. Chenery Corp., 318 U. S. 80, is not precisely apposite. See Judge Leahy's opinion, 51 F. Supp. at p. 225. In the Chenery case the Commission was dealing with the standard "fair and equitable" as applicable to trading by the management in the course of the reorganization. The language of Mr. Justice Frankfurter, however, shows the general approach of the Supreme Court to the problems presented by the Act

[fol. 159] What the Commission has done is to capitalize the chances of the common stockholders of Power to receive some value for their present interest in a going utility system. As is pointed out in the Commission's brief, absent reorganization, the preferred stockholders of Power are entitled to receive an annual dividend of $3,600,000 and they are entitled to receive all earnings in excess of that amount until the accrued dividends amounting to $38,700,000 were paid off. The Commission has estimated that a fifteen year period will be required at best to reduce the arrearages of dividends to zero. After the payment of arrearages the preferred stock would receive only $3,600,000 a year and the net annual earnings would be available for the common stock. The Commission arrived at the figure of $6,185,000 per year as its estimate of annual average earning power on a consolidated basis, but stated that this was "a very liberal assumption". It must be discounted accordingly. If the plan be carried out the preferred stockholders will give up about 5% of their exclusive claim to all of the income for a fifteen year period and 5% of their exclusive right to the first $3,600,000 of income earned thereafter. In exchange they receive a new right to 95% of the annual earnings in excess of $3,600,000, which the Commission has estimated at $2,585,000, to begin after the fifteen year period and to run as long as the system shall endure.

The Commission in its brief expresses this exchange of rights in other terms as follows. The common stockholders are giving up 100% interest in an estimated $2,585,000 annually which will begin in about fifteen years. In exchange for that right they will acquire a present 5% interest in annual earnings of $6,185,000 a year. This amounts to $309,250. The difference between $2,585,000 and $309,250, which is a ratio of about 8.4 to 1, demonstrates the extent to which the Commission weighted Power's common stockholders' allocation of the common stock of Railways in order to [fol. 160] recognize the elimination of the fifteen year delay as well as the $3,600,000 annual preference of the preferred stockholders. The Commission clearly recognized the risk that earnings available for distribution might be less than $6,185,000 a year. But for the element of risk the relationship between the future interests surrendered and the present interests to be received under the plan may be com-

pared to the difference between an annuity of $8.40 beginning fifteen years hence and an annuity of $1. a year beginning immediately. To make these annuities mathematically equivalent, the annuity of $8.40 a year would be subjected to discount to present value at the rate of 15.2% a year.

Thus, as the Commission points out, 15.2% measures the risk factor upon which the Commission based the assumption that the common stock might receive an estimated $2,585,000 a year beginning fifteen years in the future. This is a very high discount rate and expresses adequately the risk inherent in the expectation that the Commission's earnings estimate will be realized. In employing this high measure of risk factor the Commission offsets its very liberal estimate of $6,185,000 of consolidated earnings.

We think that it is apparent that the consolidated earnings of the system, absent or with reorganization, will run far in excess of the annual dividend requirements of the preferred stock of $3,600,000 a year. While the amount of accrued dividends is substantial and may not be liquidated within the fifteen year period estimated by the Commission, it is none the less apparent that the accumulated dividends will be liquidated at some future time if the system remains in business as a going concern. We cannot say that the liberal estimate of system earnings arrived at by the Commission is too liberal. That question is and must be one which remains within the expert administrative judgment of the Commission. We can and do say that in our opinion the common stockholders of Power cannot be cut out of participation in the system earnings and the plan be deemed to be fair and equitable.

[fol. 161] But, the appellant will assert in answer that the preferred stockholders of Power are entitled to all of the earnings of Power and *vice* Power to all of the earnings of Railways until they have received their arrearages of dividends. It is true that the common stockholders of Power might be given some form of participation which would entitle them in the future to all of the earnings above the preferred stockholders' dividend requirements when the arrearage of preferred dividends had been paid in full. The rights of the preferred stockholders could be limited accordingly. This, however, would introduce into a public utility holding company financing a kind of "security" of

no present value market-wise and of a type which experience has proven to be undesirable. The final answer is that the Commission did not see fit to adopt such a plan and no one has suggested it. Under the plan the preferred stockholders of Power acquire immediate control of the holding company system, a 95% interest therein, and an immediate right to the payment of dividends. This seems to us to be the equitable equivalent to the rights which they are giving up. That most of them think so is evident from the fact that with the exception of the appellant, which holds ten shares of the preferred stock, none has seen fit to appear in the District Court in objection to the plan. As the Commission has found, the allowance of about 5% of the common stock of Railways to the common stockholders of Power does "not exceed the permissible limits of fairness * * *". In the absence of an exact measuring stick or a mathematical formula, neither of which are available, it is our opinion that the Commission is entitled to apply the tests which it has applied and the result which it has reached is sanctioned by the law.

One further point remains to be disposed of. The appellee, Power, insists that the appellant was not a party to the proceeding in the District Court having a right to appeal from that court's judgment. This is based upon the theory that because Otis & Co. did not appear in the pro- [fol. 162] ceedings before the Commission and raised no objection to the plan it had no right to be heard in the District Court. The appellee cites the provisions of Section 24(a) of the Act, 15 U. S. C. A. § 78y, which provides for an appeal to this court by any person aggrieved by an order of the Commission "within sixty days after the entry of such order". Section 11 (e) as we have seen provides for a hearing before the district court after notice and opportunity for hearing. Briefly, the appellee takes the position that it was the intention of Congress to provide for judicial proceedings under Section 11 (e) only in aid of the enforcement of the Commission's order which should be subject to judicial review by the court of appeals and that the issues before the District Court should have been so limited. Power asserts that it was not the intention of Congress to provide for a full judicial review as — the validity of an order in a proceeding before the District Court. Such in the view of the appellee, is a "summary proceeding."

We cannot agree with this interpretation of the statute. While it is clear that Section 24(a) gives the circuit courts of appeals jurisdiction to review any order issued by the Commission upon the application of a party aggrieved thereby, it is equally clear that Section 11(e) contemplates that any person affected by the plan shall have the right to be heard as to whether or not the plan is fair and equitable and appropriate to effectuate the provisions of Section 11. In Commonwealth and South. Corp. v. Securities and Exch. Com'n, 134 F. (2nd) 747, 753, we indicated that stockholders whose rights were affected by an order of the Commission directing a public utility holding company to change its corporate structure had a right to be heard in that district court of the United States in which the Commission was seeking to effect its order; that otherwise those stockholders would be deprived of property without due process of law. It follows that the proceeding before the district court cannot be deemed to be a summary one. Moreover, the fact that notice is to be given [fol. 163] to the persons affected by the plan shows that the theory of submission to the District Court is substantially similar to that required in respect to a plan made pursuant to the provisions of Section 77B or Chapter X of the Bankruptcy Act. True, the issues presented to the District Court are limited to the matters prescribed by the statute but this is the extent of the limitation. Since Otis & Co. was a stockholder it was entitled to be heard. The court below treated Otis & Co. as an intervener, but even if it had not Otis & Co.'s right to appeal in the case at bar would be plain. See the provisions of Section 25 of the Act.

The judgment of the court below is affirmed.

A true Copy: Teste:

—— ——, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 164] In the United States Circuit Court of Appeals for the Third Circuit, October Term, 1943

No. 8463

In the Matter of the Application of Securities and Exchange Commission to Enforce and Carry Out a Plan to Effectuate the Provisions of Section 11 (b) of the Public Utility Holding Company Act of 1935 With Respect to The United Light and Power Company

Otis & Co., Intervening Preferred Stockholder, Appellant

Present: Biggs, Jones and McLaughlin, Circuit Judges.

On Appeal from the District Court of the United States for the District of Delaware

Judgment—Filed April 20, 1944

This cause came on to be heard on the transcript of record from the District Court of the United States, for the District of Delaware, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

By the Court, John Biggs, Jr., Circuit Judge.

April 20, 1944.

[File endorsement omitted.]

[fol. 165] In United States Circuit Court of Appeals for the Third Circuit

[Title omitted]

Order Amending Opinion—April 26, 1944

Present: Biggs, Jones and McLaughlin, Circuit Judges.

And Now, to wit this 26th day of April, 1944, the printed opinion filed herein on April 20, 1944 is amended as follows:

On page 2, twenty-sixth line from the top thereof, by

inserting the word "such" between the words "of" and "stock," so that the phrase will now read "for each share of such stock."

On page 3, sixteenth line from the top thereof, by striking out "94.5%" and substituting therefor "94.52%" and in the last line of footnote 7, by striking out "10(e)" and substituting therefor "11(e)."

On page 4, last line of footnote 9 thereof, by substituting for the semicolon after "U. S. C. 872;" a period and by striking out the words "Chapter XIII, Sec. 646, 11 U. S. C. 1046" and in lines six and seven of footnote 10 by italicizing [fol. 166] "*Duparquet Huot & Moneuse Co. v. Evans*" and in the last line of footnote 10 by italicizing "*Keck v. United States.*"

On page 7, fifth, sixth and seventh lines from the top thereof, by italicizing the phrase "*to the extent that their holding-company securities represent any real equity therein.*"

On page 9, fifteenth line from the top thereof, by striking out the word "year" and substituting therefor the word "years."

On page 10, twenty-fifth line from the top thereof, by striking out the comma between the words "true" and "since."

On page 11, nineteenth line of footnote 16 thereof, by adding a comma after the word "compelled" and on the second and third lines from the bottom of footnote 16, by striking out the hyphens between "*vis a vis*" and by italicizing the phrase in each instance.

On page 12, nineteenth line from the top thereof, by striking out "423" and substituting therefor "523".

On page 15, thirteenth line from the top thereof, by striking out "§ 78y" and substituting therefor "§ 79x(a)" and in footnote 19, the fifteenth line thereof, by inserting a comma after the word "law" and in the seventeenth line of footnote 19, by striking out the word "would" and substituting therefor the word "will".

On page 19, fourth line from the top, by striking out "§ 78y" and substituting therefor "§ 79x(a)".

For the Court, John Biggs, Jr., U. S. Circuit Judge.

[fol. 167] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 168] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1944

No. 81

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed June 12, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.